PNC FINANCIAL SERVICES GROUP INC
Form S-4
December 01, 2006
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form S-4

REGISTRATION STATEMENT

UNDER THE SECURITIES ACT OF 1933

THE PNC FINANCIAL SERVICES GROUP, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania	6712	25-1435979
(State or other jurisdiction of incorporation)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

One PNC Plaza

249 Fifth Avenue

Pittsburgh, Pennsylvania 15222-2707

(412) 762-2000

(Address, including Zip Code, and Telephone Number, including Area Code, of Registrant s Principal Executive Offices)

Richard J. Johnson

Chief Financial Officer

One PNC Plaza

249 Fifth Avenue

Pittsburgh, Pennsylvania 15222-2707

(412) 762-2000

(Name, Address, including Zip Code, and Telephone Number, including Area Code, of Agent for Service)

With copies to:

George R. Bason, Jr., Esq.

John H. Butler, Esq.

Davis Polk & Wardwell

450 Lexington Avenue

New York, New York 10017
(212) 450-3800

John L. Unger

Executive Vice President,
General Counsel and Secretary

Mercantile Bankshares Corporation

2 Hopkins Plaza

Baltimore, Maryland 21201

(410) 237-5900

Edward D. Herlihy, Esq.

Nicholas G. Demmo, Esq.

Wachtell, Lipton, Rosen & Katz

51 West 52nd Street

New York, New York 10019

(212) 403-1000

Approximate date of commencement of the proposed sale of the securities to the public: As soon as practicable after this Registration Statement becomes effective and upon completion of the merger described in the enclosed document.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, as amended, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to Be Registered	Amount to Be Registered	Proposed Maximum Offering Price per Share of Common Stock	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Common stock, par value $5.00 per share (together with related Preferred Stock	54,168,999(1)(2)	N/A	$5,815,658,269	$394,394.07(3)

Purchase Rights)

(1) As of the date hereof, rights to purchase Series G Junior Participating Preferred Stock, par value $1.00 per share, issued pursuant to the Rights Agreement, dated as of May 15, 2000, and amended as of January 1, 2003, between The PNC Financial Services Group, Inc. and The Chase Manhattan Bank, as Rights Agent (the Rights), are attached to and trade with the common stock, par value $5.00 per share, of PNC (the PNC Common Stock). The value of the attributable Rights, if any, is reflected in the market price of PNC Common Stock.

(2) Represents the maximum number of shares of PNC Common Stock estimated to be issuable upon the completion of the merger of Mercantile Bankshares Corporation with and into PNC, based on the number of shares of Mercantile common stock, par value $2.00 per share, outstanding, or reserved for issuance under various plans, as of September 30, 2006, and the exchange of each share of Mercantile common stock for 0.4184 of a share of PNC common stock or the applicable exchange ratio for Mercantile shares reserved for issuance under various plans pursuant to the formula set forth in the Agreement and Plan of Merger, dated as of October 8, 2006, by and between PNC and Mercantile.

(3) Pursuant to Rules 457(c) and 457(f) under the Securities Act of 1933, as amended, the registration fee is based on the average of the high and low sales prices of Mercantile common stock, as reported on the New York Stock Exchange on November 27, 2006, and computed based on the estimated maximum number of shares that may be exchanged for the PNC common stock being registered, including shares issuable upon exercise of outstanding options or other securities to acquire Mercantile common stock, less the amount of cash paid by PNC in exchange for shares of Mercantile common stock (which equals $2,129,732,380).

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such dates as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this proxy statement/prospectus is not complete and may be changed. We may not sell the securities offered by this proxy statement/prospectus until the registration statement filed with the Securities and Exchange Commission is effective. This proxy statement/prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction where an offer or solicitation is not permitted.

PRELIMINARY SUBJECT TO COMPLETION DATED NOVEMBER 30, 2006

MERGER PROPOSED YOUR VOTE IS VERY IMPORTANT

Dear Stockholder:

On October 8, 2006, Mercantile Bankshares Corporation entered into an agreement and plan of merger with The PNC Financial Services Group, Inc. pursuant to which Mercantile will merge with and into PNC, with PNC as the surviving corporation in the merger. You are invited to attend a special meeting of the stockholders of Mercantile on [ ] at [ ] a.m., local time, at [ ] to vote on approval of the merger. We are sending you this proxy statement/prospectus to ask you to vote on the approval of the merger at the special meeting.

If the merger is completed, Mercantile stockholders will receive a combination of PNC common stock and cash in exchange for their Mercantile common stock. Each share of Mercantile common stock will be converted into the right to receive 0.4184 of a share of PNC common stock and $16.45 in cash, without interest. The value of the stock portion of the merger consideration will fluctuate with the market price of PNC common stock. The following table shows the closing sale prices of PNC common stock as reported on the New York Stock Exchange and of Mercantile common stock as reported on the NASDAQ on October 6, 2006, the last trading day before we announced the merger, and on [ ], the last practicable trading day before the distribution of this document. This table also shows the implied value of the merger consideration proposed for each share of Mercantile common stock, which we calculated by multiplying the closing price of PNC common stock on those dates by 0.4184, the exchange ratio, and adding $16.45.

	PNC Common Stock	Mercantile Common Stock	Implied Value per Share of Mercantile Common Stock
At 10/06/06	$ 73.60	$ 36.78	$ 47.24
At [ ]	$ [ ]	$ [ ]	$ [ ]

The market prices of both PNC common stock and Mercantile common stock will fluctuate before the merger. You should obtain current stock price quotations for PNC common stock and Mercantile common stock. PNC common stock is quoted on the NYSE under the symbol PNC. Mercantile common stock is quoted on the NASDAQ under the symbol MRBK.

We expect that the merger will generally be tax-free to you as to shares of PNC common stock you receive in the merger and generally taxable to you as to the cash you receive.

We cannot complete the merger unless Mercantile s common stockholders approve it. In order for the merger to be approved, the holders of at least two-thirds of Mercantile s outstanding shares must vote in favor of the merger. Regardless of whether you plan to attend the special stockholders meeting, please take the time to vote your shares in accordance with the instructions contained in this document. Your vote is important. Failing to vote will have the same effect as voting against the merger. The Mercantile board of directors recommends that Mercantile stockholders vote FOR approval of the merger.

This document describes the special meeting, the merger, the documents related to the merger and other related matters. Please carefully read this entire document, including Risk Factors beginning on page [ ], for a discussion of the risks relating to the proposed merger. You also can obtain information about our companies from documents that each of us has filed with the Securities and Exchange Commission.

Edward J. Kelly, III

Chairman, President, and CEO

Mercantile Bankshares Corporation

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved the PNC common stock to be issued under this document or determined if this document is accurate or adequate. Any representation to the contrary is a criminal offense.

The date of this document is [ ], and it is first being mailed or otherwise delivered to Mercantile stockholders on or about [ ].

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MERCANTILE BANKSHARES CORPORATION

2 Hopkins Plaza

Baltimore, Maryland 21201

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

Mercantile Bankshares Corporation will hold a special meeting of stockholders at [ ] at [ ], local time, on [ ], 2007 to consider and vote upon the following proposals:

- to approve the merger of Mercantile Bankshares Corporation with and into The PNC Financial Services Group, Inc., on the terms set forth in the Agreement and Plan of Merger, dated as of October 8, 2006, by and between The PNC Financial Services Group, Inc. and Mercantile Bankshares Corporation, as it may be amended from time to time; and

- to approve the adjournment of the special meeting, if necessary, to solicit additional proxies, in the event that there are not sufficient votes at the time of the special meeting to approve the proposal to approve the merger.

The Mercantile board of directors has fixed the close of business on [ ] as the record date for the special meeting. Only Mercantile stockholders of record at that time are entitled to notice of, and to vote at, the special meeting, or any adjournment or postponement of the special meeting.

In order for the merger to be approved, the holders of at least two-thirds of the Mercantile shares outstanding and entitled to vote thereon must vote in favor of approval of the merger.

Regardless of whether you plan to attend the special meeting, please submit your proxy with voting instructions. Please vote as soon as possible. If you hold stock in your name as a stockholder of record, please complete, sign, date and return the accompanying proxy card in the enclosed self-addressed, stamped envelope. You may also authorize a proxy to vote your shares by either visiting the website or calling the toll-free number shown on your proxy card. If you hold your stock in street name through a bank or broker, please direct your bank or broker to vote in accordance with the instructions you have received from your bank or broker. This will not prevent you from voting in person, but it will help to secure a quorum and avoid added solicitation costs. Any holder of Mercantile common stock who is present at the special meeting may vote in person instead of by proxy, thereby canceling any previous proxy. In any event, a proxy may be revoked in writing at any time before its exercise at the special meeting in the manner described in the accompanying document.

The Mercantile board of directors has approved the merger and the merger agreement and recommends that Mercantile stockholders vote FOR approval of the merger.

BY ORDER OF THE BOARD OF DIRECTORS,

John L. Unger

Secretary

[ ], 2007

YOUR VOTE IS IMPORTANT. PLEASE VOTE YOUR SHARES PROMPTLY, REGARDLESS OF WHETHER YOU PLAN TO ATTEND THE SPECIAL MEETING. YOU CAN FIND INSTRUCTIONS FOR VOTING ON THE ENCLOSED PROXY CARD.

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REFERENCES TO ADDITIONAL INFORMATION

This document incorporates important business and financial information about PNC and Mercantile from documents that are not included in or delivered with this document. You can obtain documents incorporated by reference in this document, other than certain exhibits to those documents, by requesting them in writing or by telephone from the appropriate company at the following addresses:

The PNC Financial Services Group, Inc.	Mercantile Bankshares Corporation
One PNC Plaza	**2 Hopkins Plaza, P.O. Box 1477**
249 Fifth Avenue	**Baltimore, Maryland 21203**
Pittsburgh, Pennsylvania 15222-2707	**Attention: David E. Borowy, Investor Relations**
Attention: Investor Relations	**(410) 347-8361**
(412) 762-2000	

You will not be charged for any of these documents that you request. Mercantile stockholders requesting documents should do so by [ ] in order to receive them before the special meeting.

See Where You Can Find More Information on page [ ].

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QUESTIONS AND ANSWERS ABOUT THE SPECIAL MEETING

The questions and answers below highlight only selected procedural information from this document. They do not contain all of the information that may be important to you. You should read carefully the entire document and the additional documents incorporated by reference into this document to fully understand the voting procedures for the special meeting.

Q: What is the proposed transaction for which I am being asked to vote?

A: You are being asked to approve the merger of Mercantile with and into PNC, on the terms set forth in the Agreement and Plan of Merger, dated as of October 8, 2006, by and between The PNC Financial Services Group, Inc. and Mercantile Bankshares Corporation.

Q: What will I receive in the merger?

A: If the merger is completed, each share of Mercantile common stock that you own will be converted into the right to receive 0.4184 of a share of PNC common stock and $16.45 in cash, without interest.

Q: What do I need to do now?

A: After you have carefully read this document and have decided how you wish to vote your shares, please vote your shares promptly. If you hold stock in your name as a stockholder of record, you must complete, sign, date and mail your proxy card in the enclosed postage paid return envelope as soon as possible. You may also authorize a proxy to vote your shares by telephone or through the Internet as instructed on the proxy card. If you hold your stock in street name through a bank or broker, you must direct your bank or broker to vote in accordance with the instructions you have received from your bank or broker. Submitting your proxy card, authorizing a proxy by telephone or through the Internet, or directing your bank or broker to vote your shares will ensure that your shares are represented and voted at the special meeting.

Q: Why is my vote important?

A: Your failure to vote, by proxy or in person, will have the same effect as a vote against the merger. The merger must be approved by the holders of two-thirds of the outstanding shares of Mercantile common stock entitled to vote at the special meeting. **The Mercantile board of directors recommends that you vote FOR approval of the merger.**

Q: If my shares of common stock are held in street name by my broker, will my broker automatically vote my shares for me?

A: No. Your broker cannot vote your shares without instructions from you. You should instruct your broker as to how to vote your shares, following the directions your broker provides to you. Please check the voting form used by your broker.

Q: What if I fail to instruct my broker?

A: If you do not provide your broker with instructions, your broker generally will not be permitted to vote your shares on the merger proposal being presented at the special meeting. Because the approval of the merger requires the affirmative vote of the holders of two-thirds of the outstanding shares of Mercantile common stock, a failure to provide your broker instructions will have the same effect as a vote against the merger.

Q: Can I attend the special meeting and vote my shares in person?

A: Yes. All stockholders, including stockholders of record and stockholders who hold their shares through banks, brokers, nominees or any other holder of record, are invited to attend the special meeting. Holders of record of Mercantile common stock can vote in person at the special meeting. If you are not a stockholder of record, you must obtain a proxy, executed in your favor, from the record holder of your shares, such as a broker, bank or other nominee, to be able to vote in person at the special meeting. If you plan to attend the special meeting, you must hold your shares in your own name or have a letter from the record holder of your shares confirming your ownership and you must bring a form of personal photo identification with you in order to be admitted. We reserve the right to refuse admittance to anyone without proper proof of share ownership and without proper photo identification.

Q: Can I change my vote?

A: Yes. You may revoke any proxy at any time before it is voted by (1) signing and returning a proxy card with a later date, or by submitting another proxy via the Internet or by telephone, (2) delivering a written revocation letter to the Secretary of Mercantile, or (3) attending the special meeting in person, notifying the Secretary and voting by ballot at the special meeting. The Mercantile Secretary s mailing address is 2 Hopkins Plaza, Baltimore, Maryland 21201.

Any stockholder entitled to vote in person at the special meeting may vote in person regardless of whether a proxy has been previously given, and such vote will revoke any previous proxy but the mere presence (without notifying the Secretary of Mercantile) of a stockholder at the special meeting will not constitute revocation of a previously given proxy.

Q: If I am a Mercantile stockholder, should I send in my Mercantile stock certificates now?

A: No. You should not send in your Mercantile stock certificates at this time. After the merger, the exchange agent will send you instructions for exchanging Mercantile stock certificates for the merger consideration. Unless Mercantile stockholders specifically request to receive PNC stock certificates, the shares of PNC stock they receive in the merger will be issued in book-entry form.

Q: When do you expect to complete the merger?

A: We expect to complete the merger in the first quarter of 2007. However, we cannot assure you when or if the merger will occur. We must first obtain the approval of Mercantile stockholders at the special meeting and the necessary regulatory approvals.

Q: Whom should I call with questions?

A: Mercantile stockholders should call The Altman Group, Mercantile s proxy solicitor, at (212) 681-9600 with any questions about the merger and related transactions.

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SUMMARY

This summary highlights selected information from this document. It does not contain all of the information that is important to you. We urge you to carefully read the entire document and the other documents to which we refer in order to fully understand the merger and the related transactions. See Where You Can Find More Information on page [ ]. Each item in this summary refers to the page of this document on which that subject is discussed in more detail.

The Merger and the Merger Consideration (page [ ])

We are proposing the merger of Mercantile with and into PNC. PNC will survive the merger. If the merger is completed, you will have the right to receive 0.4184 of a share of PNC common stock and $16.45 in cash, without interest, for each share of Mercantile common stock you hold immediately prior to the merger. PNC will not issue any fractional shares of PNC common stock in the merger. Mercantile stockholders who would otherwise be entitled to a fractional share of PNC common stock will instead receive an additional amount in cash based on the average closing sale prices of PNC common stock for the five trading days immediately prior to the date on which the merger is completed.

Example: If you hold 110 shares of Mercantile common stock, you will have a right to receive 46 shares of PNC common stock, $1809.50 in cash and an additional cash payment instead of the 0.024 shares of PNC common stock that you otherwise would have received (i.e., 110 shares x 0.4184 = 46.024 shares).

What Holders of Mercantile Stock Options and Other Equity-Based Awards Will Receive (page [ ])

Upon completion of the merger:

- Each outstanding option to purchase shares of Mercantile common stock, whether vested or not, will be cancelled in exchange for the right to receive a lump sum cash payment equal to the product of (i) the number of shares of Mercantile common stock subject to the outstanding portion of the option and (ii) the excess of the all cash consideration over the exercise price per share of the option. The all cash consideration will equal the sum of (a) $16.45 and (b) the product of 0.4184 multiplied by the average of the closing sale prices of PNC common stock for the five trading days immediately preceding the date of completion of the merger. The lump sum cash payment will be subject to applicable tax withholding.

- Each outstanding restricted share and restricted stock unit of Mercantile common stock, whether vested or not, will be cancelled and converted into the right to receive, without restrictions, the merger consideration, which is (a) 0.4184 of a share of PNC common stock and (b) cash equal to $16.45. PNC will be entitled to deduct applicable tax withholding.

- Each phantom stock unit with respect to Mercantile common stock will cease to represent rights with respect to Mercantile common stock and will be converted into, at the option of Mercantile, the all cash consideration or the merger consideration or phantom stock units with respect to an equivalent number of shares of PNC common stock. If the latter option is selected, the number of phantom stock units with respect to PNC common stock would equal the number of shares of Mercantile common stock subject to such phantom stock units multiplied by the sum of (a) $16.45 divided by the average of the closing sale prices of PNC common stock for the five trading days immediately preceding the date of completion of the merger and (b) 0.4184.

The Merger Will Generally Be Tax-Free to Mercantile Stockholders Except to the Extent of the Cash They Receive (page [ ])

PNC and Mercantile have structured the merger to qualify as a reorganization for United States federal income tax purposes, and it is a condition to their respective obligations to complete the merger that each of PNC

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and Mercantile receive a legal opinion to that effect. Accordingly, the merger will generally be tax-free to you, except to the extent of the cash you receive in the merger. The amount of gain that you recognize in the merger will generally be limited to the lesser of the amount of gain that you realize and the amount of cash that you receive in the merger (except for any cash you receive instead of fractional shares). The amount of gain that you realize is generally equal to the excess, if any, of the sum of the cash and the fair market value of the PNC common stock that you receive over your tax basis in the Mercantile common stock you surrender in the merger.

The United States federal income tax consequences described above may not apply to all holders of Mercantile common stock. Your tax consequences will depend on your individual situation. Accordingly, we strongly urge you to consult your tax advisor for a full understanding of the particular tax consequences of the merger to you.

Comparative Market Prices and Share Information (pages [ ] and [ ])

PNC common stock is quoted on the NYSE under the symbol PNC. Mercantile common stock is quoted on the NASDAQ under the symbol MRBK. The following table shows the closing sale prices of PNC common stock and Mercantile common stock as reported on the NYSE and the NASDAQ on October 6, 2006, the last trading day before we announced the merger, and on [ ], the last practicable trading day before the distribution of this document. This table also shows the implied value of the merger consideration proposed for each share of Mercantile common stock, which we calculated by multiplying the closing price of PNC common stock on those dates by 0.4184, the exchange ratio, and adding $16.45, the cash portion of the merger consideration.

	PNC Common Stock	Mercantile Common Stock	Implied Value of One Share of Mercantile Common Stock
At October 6, 2006	$ 73.60	$ 36.78	$ 47.24
At [ ]	$ [ ]	$ [ ]	$ [ ]

The market price of PNC common stock and Mercantile common stock will fluctuate prior to the merger. You should obtain current market quotations for the shares.

Sandler O Neill & Partners, L.P. Has Provided an Opinion to the Mercantile Board of Directors Regarding the Merger Consideration (page [ ])

Sandler O Neill & Partners, L.P. delivered its opinion to Mercantile s board of directors that as of October 8, 2006 and based upon and subject to the factors and assumptions set forth in the opinion, the merger consideration to be received by holders of the outstanding shares of the common stock of Mercantile under the agreement and plan of merger was fair from a financial point of view.

The full text of the written opinion of Sandler O Neill, dated October 8, 2006, which sets forth the assumptions made, procedures followed, matters considered and limitations on the review undertaken in connection with the opinion, is attached as Annex B to this proxy statement/prospectus. Mercantile s shareholders are encouraged to read the opinion in its entirety. Sandler O Neill provided its opinion for the information and assistance of the Mercantile board of directors in connection with its consideration of the transaction. The Sandler O Neill opinion is not a recommendation as to how any holder of Mercantile common stock should vote with respect to the transaction.

The Mercantile Board of Directors Recommends that Mercantile Stockholders Vote FOR Approval of the Merger (page [ ])

The Mercantile board of directors believes that the merger is in the best interests of Mercantile and its stockholders and has approved the merger and the merger agreement. The Mercantile board of directors recommends that Mercantile stockholders vote FOR approval of the merger.

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Mercantile s Directors and Officers Have Financial Interests in the Merger That May Differ From Your Interests (page [ ])

In considering the information contained in this document, you should be aware that Mercantile s executive officers and directors have financial interests in the merger that may be different from, or in addition to, the interests of Mercantile stockholders. These additional interests of Mercantile s executive officers and directors may create potential conflicts of interest and cause some of these persons to view the proposed transaction differently than you may view it as a stockholder.

Mercantile s board of directors was aware of these interests and took them into account in its decision to approve and adopt the merger agreement. For information concerning these interests, please see the discussion under the caption Mercantile s Directors and Officers Have Financial Interests in the Merger.

Holders of Mercantile Common Stock Do Not Have Appraisal Rights (page [ ])

Appraisal rights are statutory rights that allow stockholders to dissent from specified extraordinary transactions, such as a merger, and to demand that the corporation pay the fair value of their shares as determined by a court in a judicial proceeding instead of receiving the consideration offered to stockholders in connection with the extraordinary transaction. Appraisal rights are not available in all circumstances, and exceptions to these rights are provided under the Maryland General Corporation Law. Because Mercantile common stock is listed on the NASDAQ, the holders of Mercantile common stock are not entitled to appraisal rights in the merger.

Conditions That Must Be Satisfied or Waived for the Merger to Occur (page [ ])

Currently, we expect to complete the merger in the first quarter of 2007. As more fully described in this document and in the merger agreement, the completion of the merger depends on a number of conditions being satisfied or, where legally permissible, waived. These conditions include, among others, approval by Mercantile stockholders, the receipt of all required regulatory approvals (such as approval by the Board of Governors of the Federal Reserve System and financial regulators in Delaware, Maryland and Virginia) without a condition or a restriction that would have a material adverse effect measured relative to Mercantile, and the receipt of legal opinions by each company regarding the tax treatment of the merger.

We cannot be certain when, or if, the conditions to the merger will be satisfied or waived, or that the merger will be completed.

Termination of the Merger Agreement (page [ ])

We may mutually agree to terminate the merger agreement before completing the merger, even after stockholder approval, as long as the termination is approved by each of our boards of directors. In addition, either of us may decide to terminate the merger agreement, even after stockholder approval, if a governmental entity issues a non-appealable final order prohibiting the merger, if a governmental entity which must grant a regulatory approval as a condition to the merger denies such approval of the merger and such denial has become final and non-appealable, or if the other party breaches the merger agreement in a way that would entitle the party seeking to terminate the agreement not to consummate the merger, subject to the right of the breaching party to cure the breach within 45 days following written notice (unless it is not possible due to the nature or timing of the breach for the breaching party to cure the breach). Either of us may terminate the merger agreement if the merger has not been completed by October 8, 2007, unless the reason the merger has not been completed by that date is a breach of the merger agreement by the company seeking to terminate the merger agreement.

PNC may terminate the merger agreement if the Mercantile board of directors (1) fails to recommend that Mercantile stockholders approve the merger, (2) withdraws or modifies its recommendation (or proposes to do so) in a manner adverse to PNC, (3) recommends an alternative business combination proposal in a manner adverse to PNC, or (4) resolves to do any of the foregoing. PNC may also terminate the merger agreement if Mercantile intentionally breaches its obligation to call and hold a stockholder meeting to consider the merger or its obligation to not solicit competing acquisition proposals.

Termination Fee (page [ ])

In the event that PNC terminates the merger agreement because

- the Mercantile board of directors (1) fails to recommend that Mercantile stockholders approve the merger, (2) withdraws or modifies its recommendation (or proposes to do so) in a manner adverse to PNC, (3) recommends an alternative business combination proposal, or (4) resolves to do any of the foregoing, or

- Mercantile intentionally breaches its obligation to call and hold a stockholder meeting to consider the merger or its obligation to not solicit competing acquisition proposals,

Mercantile will pay PNC a $225 million termination fee.

In addition, we have agreed that if certain events occur relating to a competing business combination proposal and thereafter the merger agreement is terminated by either Mercantile or PNC:

- if Mercantile consummates an alternative transaction within 12 months of termination of the merger agreement, Mercantile will pay PNC a $225 million termination fee.

- if Mercantile enters into a definitive acquisition agreement with regards to an alternative transaction within 12 months of termination of the merger agreement, Mercantile will pay PNC a $75 million termination fee. If Mercantile consummates an alternative transaction with a party or affiliate of a party to such an acquisition agreement within 18 months of termination of the merger agreement, then Mercantile will pay PNC an additional $150 million fee.

Regulatory Approvals Required for the Merger (page [ ])

Mercantile and PNC have agreed to use their reasonable best efforts to obtain all regulatory approvals required to complete the transactions contemplated by the merger agreement. These approvals include approval from the Federal Reserve Board and other state regulatory authorities, including the Delaware State Bank Commissioner, the Commissioner of Financial Regulation of the Maryland Department of Labor, Licensing and Regulation and the Bureau of Financial Institutions of the Virginia State Corporation Commission. PNC and Mercantile have completed, or will complete, the filing of applications and notifications to obtain the required regulatory approvals. In obtaining the required regulatory approvals, PNC is not required to agree to any restriction or condition that would have a material adverse effect on Mercantile or PNC, measured on a scale relative to Mercantile.

Although we do not know of any reason why we cannot obtain these regulatory approvals in a timely manner, we cannot be certain when or if we will obtain them.

The Board of Directors of PNC following Completion of the Merger (page [ ])

PNC has agreed in connection with the merger to appoint two individuals mutually agreed upon by PNC and Mercantile to the PNC board of directors effective as of the completion of the merger.

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The Rights of Mercantile Stockholders will be Governed by Pennsylvania Law and the PNC Articles of Incorporation and Bylaws after the Merger (page [ ])

The rights of Mercantile stockholders will change as a result of the merger due to differences in PNC s and Mercantile s governing documents and due to the fact that the companies are incorporated in different states (Mercantile in Maryland and PNC in Pennsylvania). Page [ ] of this document contains a description of stockholder rights under each of the PNC and Mercantile governing documents and applicable state law, and describes the material differences between them.

Mercantile will Hold its Special Meeting on [ ] (page [ ])

The special meeting will be held on [ ], at [ ] a.m., local time, at [ ]. At the special meeting, Mercantile stockholders will be asked to:

- approve the merger; and
- approve the adjournment of the special meeting, if necessary, to solicit additional proxies, in the event that there are not sufficient votes at the time of the special meeting to approve the merger.

Record Date. Only holders of record of Mercantile common stock at the close of business on [ ] will be entitled to vote at the special meeting. Each share of Mercantile common stock is entitled to one vote. As of the record date of [ ], there were [ ] shares of Mercantile common stock entitled to vote at the special meeting.

Required Vote. To approve the merger, the holders of at least two-thirds of the outstanding shares of Mercantile common stock entitled to vote must vote in favor of approving the merger. Because approval is based on the affirmative vote of at least two-thirds of shares outstanding, a Mercantile stockholder s failure to vote or an abstention will have the same effect as a vote against the merger.

As of the record date, directors and executive officers of Mercantile and their affiliates had the right to vote [ ] shares of Mercantile common stock, or [ ]% of the outstanding Mercantile common stock entitled to be voted at the special meeting. At that date, directors and executive officers of PNC and their affiliates had the right to vote [ ] shares of Mercantile common stock entitled to be voted at the special meeting, or [ ]% of the outstanding Mercantile common stock. We currently expect that each of these individuals will vote his or her shares of Mercantile common stock in favor of the proposals to be presented at the special meeting.

Information about the Companies (page [ ])

The PNC Financial Services Group, Inc.

The PNC Financial Services Group, Inc. is a Pennsylvania corporation, a bank holding company and a financial holding company under U.S. federal law. PNC is one of the largest diversified financial services companies in the United States based on assets, operating businesses engaged in retail banking, corporate and institutional banking, asset management and global fund processing services. PNC provides many of its products and services nationally and others in PNC s primary geographic markets located in Pennsylvania; New Jersey; the greater Washington, DC area, including Maryland and Virginia; Ohio; Kentucky; and Delaware. PNC also provides certain global fund processing services internationally. PNC stock (NYSE: PNC) is listed on the New York Stock Exchange. As of September 30, 2006, PNC had total consolidated assets of approximately $98.4 billion, total consolidated deposits of approximately $64.6 billion and total consolidated stockholders equity of approximately $10.8 billion. The principal executive offices of PNC are located at One PNC Plaza, 249 Fifth Avenue, Pittsburgh, Pennsylvania 15222-2707, and its telephone number is (412) 762-2000.

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Mercantile Bankshares Corporation

Mercantile Bankshares Corporation is a Maryland corporation and a regional multibank holding company and a financial holding company headquartered in Baltimore, Maryland. It is comprised of 11 banks and a mortgage banking company. Eight banks are headquartered in Maryland, two are in Virginia and one is in Delaware. Mercantile s largest bank, Mercantile-Safe Deposit and Trust Company, represents approximately 45% of Mercantile s total assets and operates 40 offices in Maryland, 13 in Virginia, two in Washington, D.C. and one in Pennsylvania as of December 31, 2005. Nearly all of Mercantile s wealth management operations and specialized corporate banking services are provided by Mercantile-Safe Deposit and Trust Company. Through its affiliated banks, Mercantile provides a full range of banking services, including mortgage, trust and investment services, designed to meet the financial needs of its customers. Mercantile Bankshares Corporation stock (NASDAQ: MRBK) is listed on The NASDAQ Global Select Market. As of September 30, 2006, Mercantile had total consolidated assets of approximately $17.6 billion, including total consolidated deposits of approximately $12.8 billion, and total consolidated stockholders equity of approximately $2.4 billion. The principal executive offices of Mercantile are located at 2 Hopkins Plaza, Baltimore, Maryland 21201 and its telephone number is (410) 237-5900.

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SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA OF PNC

Set forth below are highlights from PNC s consolidated financial data as of and for the years ended December 31, 2001 through 2005 and as of and for the nine months ended September 30, 2005 and 2006. The results of operations for the nine months ended September 30, 2006 are not necessarily indicative of the results of operations for the full year or any other interim period. PNC management prepared the unaudited information on the same basis as it prepared PNC s audited consolidated financial statements. In the opinion of PNC management, this information reflects all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of this data for those dates. You should read this information in conjunction with PNC s consolidated financial statements and related notes included in PNC s Annual Report on Form 10-K for the year ended December 31, 2005, and PNC s Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, which are incorporated by reference in this document and from which this information is derived. See Where You Can Find More Information on page [ ].

PNC Summary of Consolidated Financial Data

	Nine months ended September 30,		Year ended December 31,				
	2006(a)	2005	2005	2004	2003	2002	2001(b)
Earnings (in millions)							
Net interest income	$ 1,679	$ 1,599	$ 2,154	$ 1,969	$ 1,996	$ 2,197	$ 2,262
Provision for (recoveries of) credit losses	82	(3)	21	52	177	309	903
Noninterest income	5,358	3,019	4,173	3,572	3,263	3,197	2,652
Noninterest expense	3,498	3,199	4,344	3,744	3,482	3,227	3,414
Income from continuing operations before minority and noncontrolling interests and income taxes	3,457	1,422	1,962	1,745	1,600	1,858	597
Minority and noncontrolling interests in income of consolidated entities	23	29	33	10	32	37	33
Income taxes	1,215	423	604	538	539	621	187
Income from continuing operations	2,219	970	1,325	1,197	1,029	1,200	377
(Loss) Income from discontinued operations, net of tax						(16)	5
Income before cumulative effect of accounting change	2,219	970	1,325	1,197	1,029	1,184	382
Cumulative effect of accounting change, net of tax					(28)		(5)
Net income	$ 2,219	$ 970	$ 1,325	$ 1,197	$ 1,001	$ 1,184	$ 377
Per common share data							
Basic earnings (loss)							
Continuing operations	$ 7.60	$ 3.40	$ 4.63	$ 4.25	$ 3.68	$ 4.23	$ 1.27
Discontinued operations						(0.05)	0.02
Before cumulative effect of accounting change	7.60	3.40	4.63	4.25	3.68	4.18	1.29
Cumulative effect of accounting change					(0.10)		(0.02)
Net income	$ 7.60	$ 3.40	$ 4.63	$ 4.25	$ 3.58	$ 4.18	$ 1.27

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	Nine months ended September 30, 2006(a)	2005	Year ended December 31, 2005	2004	2003	2002	2001(b)
Diluted earnings (loss)							
Continuing operations	$ 7.46	$ 3.35	$ 4.55	$ 4.21	$ 3.65	$ 4.20	$ 1.26
Discontinued operations						(0.05)	0.02
Before cumulative effect of accounting change	7.46	3.35	4.55	4.21	3.65	4.15	1.28
Cumulative effect of accounting change					(0.10)		(0.02)
Net income	$ 7.46	$ 3.35	$ 4.55	$ 4.21	$ 3.55	$ 4.15	$ 1.26
Period end balances (in millions)							
Total assets	$ 98,436	$ 93,241	$ 91,954	$ 79,723	$ 68,168	$ 66,377	$ 69,638
Total deposits	64,572	60,214	60,275	53,269	45,241	44,982	47,304
Total borrowed funds	14,695	18,374	16,897	11,964	11,453	9,116	12,090
Total shareholders equity	10,758	8,317	8,563	7,473	6,645	6,859	5,823

(a) Noninterest income for the nine months ended September 30, 2006 included the pretax impact of the following: gain on the BlackRock/MLIM transaction of $2.1 billion; securities portfolio rebalancing loss of $196 million; and mortgage loan portfolio repositioning loss of $48 million.

Noninterest expense for the nine months ended September 30, 2006 included the pretax impact of BlackRock/MLIM transaction integration costs of $91 million.

The aggregate after-tax impact of these items increased net income for the nine months ended September 30, 2006 by $1.1 billion. On a per share basis, the aggregate after-tax impact of these items increased net income by $3.75 per basic common share or $3.69 per diluted common share.

(b) Results for 2001 reflected the cost of actions taken during the year to accelerate the repositioning of PNC s institutional lending business and other strategic initiatives. These charges totaled $1.2 billion pre-tax and reduced 2001 net income by $768 million or $2.65 per diluted share.

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SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA OF MERCANTILE

Set forth below are highlights from Mercantile s audited consolidated financial data as of and for the years ended December 31, 2001 through 2005 and Mercantile s unaudited consolidated financial data as of and for the nine months ended September 30, 2005 and 2006. The results of operations for the nine months ended September 30, 2006 and 2005 are not necessarily indicative of the results of operations for the full year or any other interim period. The unaudited information was prepared on the same basis as Mercantile s audited consolidated financial statements. In the opinion of Mercantile management, this information reflects all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of this data for those dates. You should read this information in conjunction with Mercantile s consolidated financial statements and related notes included in Mercantile s Annual Report on Form 10-K for the year ended December 31, 2005, and Mercantile s Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, which are incorporated by reference in this document and from which this information is derived. See Where You Can Find More Information on page [ ].

Mercantile Summary of Consolidated Financial Data

	Nine months ended September 30, 2006	Nine months ended September 30, 2005	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Earnings (in millions)							
Net interest income	$ 486	$ 455	$ 617	$ 545	$ 472	$ 441	$ 417
Provision for credit losses	0	2	2	7	12	16	13
Noninterest income	185	181	243	214	184	144	146
Noninterest expense	329	312	420	392	337	273	264
Income before income taxes	342	322	438	360	307	296	286
Income taxes	127	120	162	131	110	106	105
Net income	$ 215	$ 202	$ 276	$ 229	$ 197	$ 190	$ 181
Per common share data							
Basic net income	$ 1.74	$ 1.67	$ 2.28	$ 1.93	$ 1.80	$ 1.82	$ 1.71
Diluted net income	$ 1.73	$ 1.65	$ 2.26	$ 1.92	$ 1.79	$ 1.81	$ 1.70
Period end balances (in millions)							
Total assets	$ 17,575	$ 16,403	$ 16,422	$ 14,426	$ 13,695	$ 10,790	$ 9,929
Total deposits	12,775	12,040	12,077	10,799	10,263	8,261	7,447
Total borrowed funds	2,219	2,047	1,980	1,579	1,457	1,111	1,123
Total shareholders equity	2,393	2,151	2,915	1,918	1,841	1,324	1,230

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COMPARATIVE PER SHARE DATA

The following table sets forth for PNC common stock and Mercantile common stock certain historical, pro forma and pro forma-equivalent per share financial information. The pro forma and pro forma-equivalent per share information gives effect to the merger as if the merger had been effective on the dates presented, in the case of the book value data, and as if the merger had become effective on January 1, 2005, in the case of the net income and dividends declared data. The pro forma data in the tables assume that the merger is accounted for using the purchase method of accounting and represents a current estimate based on available information of the combined company s results of operations. The pro forma financial adjustments record the assets and liabilities of Mercantile at their estimated fair values and are subject to adjustment as additional information becomes available and as additional analyses are performed. See Accounting Treatment on page [ ]. The information in the following table is based on, and should be read together with, the historical financial information that we have presented in our prior filings with the Securities and Exchange Commission, which we refer to as the SEC. See Where You Can Find More Information on page [ ].

We anticipate that the merger will provide the combined company with financial benefits that include reduced operating expenses and revenue enhancement opportunities. The pro forma information, while helpful in illustrating the financial characteristics of the combined company under one set of assumptions, does not reflect the impact of possible revenue enhancements, expense efficiencies, asset dispositions and share repurchases, among other factors, that may result as a consequence of the merger and, accordingly, does not attempt to predict or suggest future results. It also does not necessarily reflect what the historical results of the combined company would have been had our companies been combined during these periods. The Comparative Per Share Data Table for the nine months ended September 30, 2006 and the year ended December 31, 2005 combines the historical income per share data of PNC and its subsidiaries and Mercantile and its subsidiaries giving effect to the merger as if the merger had become effective on January 1, 2005, using the purchase method of accounting. Upon completion of the merger, the operating results of Mercantile will be reflected in the consolidated financial statements of PNC on a prospective basis.

	PNC Historical	Mercantile Historical	Pro Forma Combined	Pro Forma Equivalent Mercantile Share
Net income for the twelve months ended December 31, 2005:				
Basic	$ 4.63	$ 2.28	$ 4.42	$ 1.85
Diluted	4.55	2.26	4.36	1.82
Net income for the nine months ended September 30, 2006:				
Basic (1)	7.60	1.74	6.84	2.86
Diluted (1)	7.46	1.73	6.73	2.82
Dividends Declared:				
For the year ended December 31, 2005	2.00	0.99	2.00	0.84
For the nine months ended September 30, 2006	1.60	0.82	1.60	0.67
Book Value:				
As of December 31, 2005	29.21	17.81	35.67	14.92
As of September 30, 2006	36.60	19.07	41.92	17.54

(1) See note (a) on page 8.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This document contains or incorporates by reference a number of forward-looking statements, including statements about the financial conditions, results of operations, earnings outlook and prospects of PNC, Mercantile and the potential combined company and may include statements for the period following the completion of the merger. Forward-looking statements are typically identified by words such as plan, believe, expect, anticipate, intend, outlook, estimate, forecast, project and other similar words and expressions.

The forward-looking statements involve certain risks and uncertainties. The ability of either PNC or Mercantile to predict results or the actual effects of its plans and strategies, or those of the combined company, is subject to inherent uncertainty. Factors that may cause actual results or earnings to differ materially from such forward-looking statements include those set forth below under Risk Factors, as well as, among others, the following:

- those discussed and identified in public filings with the SEC made by PNC or Mercantile;
- completion of the merger is dependent on, among other things, receipt of stockholder and regulatory approvals, the timing of which cannot be predicted with precision and which may not be received at all;
- the merger may be more expensive to complete than anticipated, including as a result of unexpected factors or events;
- the integration of Mercantile s business and operations with those of PNC may take longer than anticipated, may be more costly than anticipated and may have unanticipated adverse results relating to Mercantile s or PNC s existing businesses; and
- the anticipated cost savings and other synergies of the merger may take longer to be realized or may not be achieved in their entirety, and attrition in key client, partner and other relationships relating to the merger may be greater than expected.

Because these forward-looking statements are subject to assumptions and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements. You are cautioned not to place undue reliance on these statements, which speak only as of the date of this document or the date of any document incorporated by reference in this document.

All subsequent written and oral forward-looking statements concerning the merger or other matters addressed in this document and attributable to PNC or Mercantile or any person acting on their behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this document. Except to the extent required by applicable law or regulation, PNC and Mercantile undertake no obligation to update these forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.

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RISK FACTORS

In addition to general investment risks and the other information contained in or incorporated by reference into this document, including the matters under the caption Cautionary Statement Regarding Forward-Looking Statements and the matters discussed under the caption Risk Factors included in the Annual Reports on Form 10-K filed by each of PNC and Mercantile for the year ended December 31, 2005 as updated by subsequently filed Forms 10-Q and 10-K, you should carefully consider the following factors in deciding whether to vote for adoption of the merger agreement.

Because the Market Price of PNC Common Stock Will Fluctuate, Mercantile Stockholders Cannot Be Sure of the Trading Price of the Merger Consideration They Will Receive.

Upon completion of the merger, each share of Mercantile common stock will be converted into merger consideration consisting of 0.4184 of a share of PNC common stock and $16.45 in cash. The market value of the stock portion of the merger consideration may vary from the closing price of PNC common stock on the date we announced the merger, on the date we mailed this document to Mercantile stockholders, on the date of the special meeting of the Mercantile stockholders and thereafter. Any change in the market value of PNC common stock prior to completion of the merger will affect the implied value of the merger consideration that Mercantile stockholders will receive upon completion of the merger. Accordingly, at the time of the special meeting, Mercantile stockholders will not know or be able to calculate the market value of the merger consideration they would receive upon completion of the merger. Neither company is permitted to terminate the merger agreement solely because of changes in the market prices of either company s stock. There will be no adjustment to the merger consideration for changes in the market price of either shares of PNC common stock or shares of Mercantile common stock. Stock price changes may result from a variety of factors, including general market and economic conditions, changes in our respective businesses, operations and prospects, and regulatory considerations. Many of these factors are beyond our control. You should obtain current market quotations for shares of PNC common stock and for shares of Mercantile common stock.

We May Fail To Realize All of the Anticipated Benefits of the Merger.

The success of the merger will depend, in part, on our ability to realize the anticipated benefits and cost savings from combining the businesses of PNC and Mercantile. However, to realize these anticipated benefits and cost savings, we must successfully combine the businesses of PNC and Mercantile. If we are not able to achieve these objectives, the anticipated benefits and cost savings of the merger may not be realized fully or at all or may take longer to realize than expected.

PNC and Mercantile have operated and, until the completion of the merger, will continue to operate, independently. It is possible that the integration process could result in the loss of key employees, the disruption of each company s ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients, customers, depositors and employees or to achieve the anticipated benefits of the merger. Integration efforts between the two companies will also divert management attention and resources. These integration matters could have an adverse effect on each of Mercantile and PNC during the transition period.

The Market Price of PNC Common Stock after the Merger May Be Affected by Factors Different from Those Affecting the Shares of Mercantile or PNC Currently.

The businesses of PNC and Mercantile differ and, accordingly, the results of operations of the combined company and the market price of the combined company s shares of common stock may be affected by factors different from those currently affecting the independent results of operations of Mercantile. For a discussion of the businesses of PNC and Mercantile and of certain factors to consider in connection with those businesses, see the documents incorporated by reference in this document and referred to under Where You Can Find More Information.

The Merger Agreement Limits Mercantile s Ability to Pursue Alternatives to the Merger.

The merger agreement contains no shop provisions that, subject to specified exceptions, limit Mercantile s ability to discuss, facilitate or commit to competing third-party proposals to acquire all or a significant part of Mercantile, as well as a termination fee that is payable by Mercantile under certain circumstances. These provisions might discourage a potential competing acquiror that might have an interest in acquiring all or a significant part of Mercantile from considering or proposing that acquisition even if it were prepared to pay consideration with a higher per share market price than that proposed in the merger, or might result in a potential competing acquiror proposing to pay a lower per share price to acquire Mercantile than it might otherwise have proposed to pay.

The Merger is Subject to the Receipt of Consents and Approvals from Government Entities that May Impose Conditions that Could Have an Adverse Effect on PNC.

Before the merger may be completed, various approvals or consents must be obtained from the Federal Reserve Board and various domestic and foreign bank regulatory, antitrust, insurance and other authorities. These governmental entities, including the Federal Reserve Board, may impose conditions on the completion of the merger or require changes to the terms of the merger. Although PNC and Mercantile do not currently expect that any such conditions or changes will be imposed, there can be no assurance that they will not be, and such conditions or changes could have the effect of delaying completion of the merger or imposing additional costs on or limiting the revenues of PNC following the merger, any of which might have an adverse effect on PNC following the merger. PNC is not obligated to complete the merger if the regulatory approvals received in connection with the completion of the merger include any conditions or restrictions that, in the aggregate, would reasonably be expected to have a material adverse effect on Mercantile or PNC, measured relative to Mercantile, but PNC could choose to waive this condition.

Mercantile Executive Officers and Directors Have Financial Interests in the Merger that May be Different from, or in Addition to, the Interests of Mercantile Stockholders.

Mercantile s officers and directors have financial interests in the merger that may be different from, or in addition to, the interests of Mercantile stockholders. For example, certain executive officers and employees of Mercantile may receive severance, tax gross up, bonus or retention payments, or payments with respect to outstanding equity awards, and two of the directors of Mercantile will be retained as directors of PNC and receive compensation for their services as directors of PNC.

Mercantile s board of directors was aware of these interests and took them into account in its decision to approve and adopt the merger agreement. For information concerning these interests, please see the discussion under the caption Mercantile s Directors and Officers Have Financial Interests in the Merger.

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THE MERCANTILE SPECIAL MEETING

This section contains information about the special meeting of Mercantile stockholders that has been called to consider and approve the merger of Mercantile with and into PNC, with PNC as the surviving corporation in the merger.

Together with this document, we are also sending you a notice of the special meeting and a form of proxy that is solicited by the Mercantile board of directors. The special meeting will be held on [ ], 2007, at [ ] local time, at [ ], subject to any adjournments or postponements.

Matters to Be Considered

The purpose of the special meeting is to vote on a proposal for approval of the merger.

You also will be asked to vote upon a proposal to approve the adjournment of the special meeting, if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the merger.

Proxies

Each copy of this document mailed to holders of Mercantile common stock is accompanied by a form of proxy with instructions for voting. If you hold stock in your name as a stockholder of record, you should complete and return the proxy card accompanying this document to ensure that your vote is counted at the special meeting, or at any adjournment or postponement of the special meeting, regardless of whether you plan to attend the special meeting. You may also authorize a proxy to vote your shares by telephone or through the Internet as instructed on the proxy card.

If you hold your stock in street name through a bank or broker, you must direct your bank or broker to vote in accordance with the instructions you have received from your bank or broker.

If you hold stock in your name as a stockholder of record, you may revoke any proxy at any time before it is voted by (1) signing and returning a proxy card with a later date or submitting another proxy via the Internet or by telephone, (2) delivering a written revocation letter to Mercantile s Secretary or (3) attending the special meeting in person, notifying the Secretary, and voting by ballot at the special meeting. If you hold your stock in street name through a bank or broker, you must follow your bank s or broker s instructions to revoke your proxy.

Any stockholder entitled to vote in person at the special meeting may vote in person regardless of whether a proxy has been previously given, and such vote will revoke any previous proxy but the mere presence (without notifying Mercantile s Secretary) of a stockholder at the special meeting will not constitute revocation of a previously given proxy.

Written notices of revocation and other communications about revoking your proxy should be addressed to:

Mercantile Bankshares Corporation

2 Hopkins Plaza

Baltimore, Maryland 21201

Attention: Secretary

All shares represented by valid proxies that we receive through this solicitation, and that are not revoked, will be voted in accordance with your instructions on the proxy card. If you make no specification on your proxy card as to how you want your shares voted before signing and returning it, your proxy will be voted FOR approval of the merger and FOR approval of the proposal to adjourn the special meeting, if necessary, to solicit

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additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the merger. According to the Mercantile bylaws, business to be conducted at a special meeting of stockholders may only be brought before the meeting by means of Mercantile s notice of the meeting. Accordingly, no matters other than the matters described in this document will be presented for action at the special meeting or at any adjournment or postponement of the special meeting.

Mercantile stockholders should **not** send Mercantile stock certificates with their proxy cards. After the merger is completed, holders of Mercantile common stock will be mailed a transmittal form with instructions on how to exchange their Mercantile stock certificates for shares of PNC common stock, the cash portion of the merger consideration and cash instead of fractional shares of PNC common stock, if applicable.

Solicitation of Proxies

Mercantile will bear the entire cost of soliciting proxies from you. In addition to solicitation of proxies by mail, Mercantile will request that banks, brokers and other record holders send proxies and proxy material to the beneficial owners of Mercantile common stock and secure their voting instructions. Mercantile will reimburse the record holders for their reasonable expenses in taking those actions. Mercantile has also made arrangements with The Altman Group to assist in soliciting proxies and have agreed to pay them $10,000 plus reasonable expenses for these services. If necessary, Mercantile may use several of its regular employees, who will not be specially compensated, to solicit proxies from Mercantile stockholders, either personally or by telephone, facsimile, letter or other electronic means.

Record Date

The close of business on [ ] has been fixed as the record date for determining the Mercantile stockholders entitled to receive notice of and to vote at the special meeting. At that time, [ ] shares of Mercantile common stock were outstanding, held by approximately [ ] holders of record.

Voting Rights and Vote Required

The presence, in person or by properly executed proxy, of the holders of a majority of the outstanding shares of Mercantile common stock entitled to vote is necessary to constitute a quorum at the special meeting. Abstentions will be counted for the purpose of determining whether a quorum is present.

Approval of the merger requires the affirmative vote of the holders of at least two thirds of the outstanding shares of Mercantile common stock entitled to vote at the special meeting. You are entitled to one vote for each share of Mercantile common stock you held as of the record date. The failure to vote by proxy or in person will have the same effect as a vote against the merger.

The Mercantile board of directors urges you to promptly vote by completing, dating and signing the accompanying proxy card and to return it promptly in the enclosed postage-paid envelope or to vote by telephone or through the Internet, or, if you hold your stock in street name through a bank or broker, by following the voting instructions of your bank or broker.

As of the record date:

- Directors and executive officers of Mercantile and their affiliates, had the right to vote [ ] shares of Mercantile common stock, or [ ]% of the outstanding Mercantile common stock at that date. We currently expect that each of these individuals will vote their shares of Mercantile common stock in favor of the proposals to be presented at the special meeting.

- Directors and executive officers of PNC and their affiliates had the right to vote [ ] shares of Mercantile common stock, or [ ]% of the outstanding Mercantile common stock on that date. We

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currently expect that each of these individuals will vote their shares of Mercantile common stock in favor of the proposals to be presented at the special meeting.

Recommendation of the Mercantile Board of Directors

The Mercantile board of directors has approved the merger agreement and the transactions it contemplates, including the merger. The Mercantile board of directors determined that the merger, merger agreement and the transactions contemplated by the merger agreement are advisable and in the best interests of Mercantile and its stockholders and recommends that you vote FOR approval of the merger. See The Merger Mercantile s Reasons for the Merger; Recommendation of the Mercantile Board of Directors for a more detailed discussion of the Mercantile board of directors recommendation.

Attending the Meeting

All holders of Mercantile common stock, including stockholders of record and stockholders who hold their shares through banks, brokers, nominees or any other holder of record, are invited to attend the special meeting. Stockholders of record can vote in person at the special meeting. If you are not a stockholder of record, you must obtain a proxy executed in your favor from the record holder of your shares, such as a broker, bank or other nominee, to be able to vote in person at the special meeting. If you plan to attend the special meeting, you must hold your shares in your own name or have a letter from the record holder of your shares confirming your ownership and you must bring a form of personal photo identification with you in order to be admitted. We reserve the right to refuse admittance to anyone without both proper proof of share ownership and proper photo identification.

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THE MERGER

Background of the Merger

The Mercantile board of directors has periodically discussed and reviewed Mercantile s business, strategic direction, performance and prospects in the context of developments in the financial services industry and the competitive landscape in the markets in which Mercantile operates and elsewhere. The Mercantile board of directors has also at times discussed with senior management various potential strategic alternatives involving possible acquisitions or business combinations that could complement and enhance the company s competitive strengths and strategic position. Also, senior management of Mercantile has, from time to time, had informal discussions with representatives of other financial institutions regarding industry trends and issues and exploratory discussions of the potential benefits and issues arising from possible combinations among various industry players.

PNC s board of directors and senior management also regularly review the financial services industry environment, including the trend towards consolidation in the industry, and periodically discuss ways in which to enhance the company s competitive position. Senior management of PNC has, over time, considered the possibility of acquisitions and strategic combinations with a variety of financial institutions and the potential strategic fit with such institutions based on their lines of businesses, their management and employee cultures and their geographic locations.

In the summer of 2006, Edward J. Kelly, III, Mercantile s Chairman and Chief Executive Officer, was approached by two financial institutions (neither of which was PNC) that expressed interest in exploring a potential acquisition of Mercantile. Following discussions with the two institutions, Mr. Kelly discussed these developments and other strategic alternatives with Mercantile s board of directors on September 11, 2006 and then later discussed these developments and strategic alternatives with Mercantile s senior management team. As a result of these discussions, it was felt that further dialogue with one of the two institutions would not be productive due to the range of potential values indicated by that institution, but that further dialogue with the other institution might be advisable.

In addition, in mid-September 2006, Jim Rohr, Chairman and Chief Executive Officer of PNC, and Mr. Kelly had a telephone conversation in which they agreed to meet to discuss the possibility of a strategic combination of PNC and Mercantile.

On September 22, 2006, Mr. Kelly met with senior members of Mercantile s senior management to discuss further a possible acquisition of Mercantile. Later the same day, a special meeting of the Mercantile board was held to discuss strategic alternatives, including a possible acquisition of Mercantile. Financial and legal advisors to Mercantile participated in this meeting. The Mercantile board instructed Mr. Kelly to continue contacts regarding a possible transaction with representatives of PNC and the institution that the board had previously determined might warrant additional dialogue.

On September 25, 2006, Mr. Kelly met with the CEO of the non-PNC financial institution referenced in the prior paragraph to discuss a potential acquisition of Mercantile. However, the potential range of values expressed by this potential acquirer was at a level that was not considered sufficient to justify further discussions.

On September 26, 2006, Messrs. Rohr and Kelly, together with representatives of Sandler O Neill and Wachtell Lipton, met to discuss the possibility of a potential merger of Mercantile with PNC. At this meeting, Mr. Rohr indicated to Mr. Kelly that, subject to due diligence, the finalization of the other terms and conditions of a combination and final PNC board approval, PNC would be prepared to undertake a transaction at a purchase price with a value of approximately $47 per share consisting of a mix of cash and stock. As a result of this meeting, the two determined that it would be in the best interests of both companies to continue to have further discussions, and Mr. Kelly agreed that he would discuss the potential for continued discussions with the Mercantile board.

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On September 29, 2006 the Mercantile board of directors held a special meeting. At this meeting, the Mercantile board met with senior management of Mercantile and the company s outside advisors, including representatives of Sandler O Neill and Davis Polk & Wardwell. Mr. Kelly reviewed with the Mercantile board his discussions with Mr. Rohr and PNC s preliminary indicative price, and Mr. Kelly and senior management discussed the potential for a combination with PNC in view of Mercantile s recent financial performance and prospects, consolidation activity in the financial services industry and the general financial services environment, and the long-term trends and other developments in the markets in which Mercantile conducts business. Representatives of Sandler O Neill made a presentation to the board regarding the potential transaction, PNC and the pro forma combined enterprise, and described Sandler O Neill s preliminary financial analysis regarding the potential transaction. The board, management and the company s advisors also discussed PNC and its financial and strategic position, noting the greater scale and scope that would result from a combination, their belief that PNC and Mercantile enjoyed similar cultures and business philosophies, and their belief that a combination of the two companies could provide benefits to stockholders, customers, employees and the communities Mercantile serves. At the conclusion of this meeting the Mercantile board authorized management to continue to explore the possibility of a potential merger with PNC, to further develop the terms of such a merger and to commence due diligence regarding such a potential transaction. In addition, the board also concurred with the conclusions of Mr. Kelly and senior management of Mercantile that the goal of developing highest value for Mercantile shareholders would be best served by ceasing further discussions with any other potential acquirors and focusing the efforts of the negotiating team on the opportunity for a transaction with PNC.

On October 2, 2006, PNC and Mercantile entered into a customary confidentiality agreement and began their respective due diligence investigations. Over the course of the week of October 2, the parties, together with their financial, legal and other advisors, continued their diligence investigations and discussions relating to the key terms of a transaction. Also during this period, counsel to PNC and Mercantile, working with the companies, began to draft and negotiate definitive transaction documentation, and PNC and Mercantile updated their respective boards regarding the status of discussions and the results of the on-going due diligence investigations.

On October 8, 2006, following the conclusion of due diligence, the Mercantile board of directors met. A representative of Venable, LLP described the board s duties and responsibilities under Maryland law, and responded to questions from directors. Mr. Kelly updated the board on the progress of negotiations with PNC, described the key elements of the proposed merger and discussed with the board the strategic reasons for the proposed merger. Senior management then described to the board the due diligence regarding PNC conducted by Mercantile and its advisors. Representatives of Sandler O Neill then presented a summary of its financial analysis of the proposed merger and delivered its opinion that, as of that date, the consideration to be received by Mercantile s stockholders in the merger was fair from a financial point of view to Mercantile s stockholders. A discussion followed. A representative of Davis Polk then made a presentation to the board describing the key terms of the merger and the merger agreement, and a discussion followed. Discussion followed concerning the amounts to be received by certain members of management in connection with a potential transaction. Following further discussion and deliberations, the members of the board present at the meeting unanimously approved the merger agreement and the transactions contemplated by the merger agreement and resolved to recommend that Mercantile s stockholders vote to adopt the merger agreement.

Also on October 8, the PNC board of directors held a special meeting at which members of PNC s senior management and PNC s legal and financial advisors made various presentations about, and the board discussed, the potential strategic combination with Mercantile and the proposed terms of the merger. At this meeting, the PNC board approved the merger agreement and the transactions contemplated by the merger agreement.

Following approval of each board of directors, the parties and their counsel continued to finalize and document the legal terms of the definitive documentation for the transaction. Thereafter, the parties executed the merger agreement and on October 9, 2006, the transaction was announced in a joint press release.

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Mercantile s Reasons for the Merger; Recommendation of the Mercantile Board of Directors

In reaching its conclusion that the merger agreement and the merger are advisable and in the best interests of Mercantile and its stockholders, and in approving the merger agreement and the transactions contemplated thereby, Mercantile s board of directors considered and reviewed the transaction and its terms with Mercantile s senior management, as well as its financial and legal advisors, and considered a number of factors. The following include the material factors considered by Mercantile s board of directors:

The value to be received by Mercantile stockholders under the merger agreement relative to the historical trading price of Mercantile common stock, including the fact that as of the date of the merger agreement, the merger consideration represented a premium of approximately 28% over the closing price of Mercantile common stock on October 6, 2006, the last trading day before the merger agreement was signed.

The ability of Mercantile stockholders, through the PNC common stock component of the merger consideration, to participate in the potential growth of the combined PNC and Mercantile institutions following consummation of the transaction.

The financial analyses conducted by Sandler O Neill and its opinion to the board of directors that, as of the date of the merger agreement, the consideration to be received by Mercantile s stockholders was fair from a financial point of view to Mercantile s stockholders.

The expectation that the receipt of PNC common stock by Mercantile stockholders would generally be tax-free for U.S. federal income tax purposes.

The potential alternatives available to Mercantile, including other potential extraordinary transactions and the alternative of remaining independent, and the risks and challenges inherent in successfully implementing Mercantile s business plans.

The interest rate and economic environment and management s view of their impact on regional banks like Mercantile over the near and medium term.

The competitive environment facing regional banks like Mercantile, and management s belief that Mercantile s customers and employees would benefit from a combination with PNC due to the combined entity s enhanced ability to serve its customers more broadly and effectively because of the combined entity s greater scale, broader product portfolio, stronger retail platform and robust technology.

The fact that Mercantile has minimal overlap with PNC, and the resulting opportunity for PNC to extend its franchise to Mercantile s branch networks, lending franchises and institutional wealth management clients while retaining and utilizing Mercantile s customer-facing employees and management s belief that the minimal overlap would provide opportunities to Mercantile employees in the combined PNC-Mercantile organization that may not typically be available in acquisitions involving organizations with a greater overlap of businesses.

Management s belief in the compatibility of PNC s and Mercantile s culture and focus on traditional customer segments, regional structure, dedication to customer service and commitment to their communities.

The results of the due diligence investigation of PNC conducted by Mercantile s management and advisors.

The previous experience of PNC s management in successfully integrating acquisition transactions, including Riggs National Bank.

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Management s belief that the merger would likely be approved by the appropriate regulatory authorities without undue conditions or delay and in accordance with the terms proposed.

The terms and conditions of the merger agreement, including:

- the limited number and nature of the conditions to PNC s obligation to consummate the merger;

- the $25 million donation that the PNC Foundation will make at the effective time of the merger to Mercantile s foundation for charitable causes in the Baltimore area;

- PNC s agreement to provide Mercantile employees with aggregate salary and benefits that are substantially similar to the salary and benefits provided by Mercantile prior to the merger or that are no less favorable than the salary and benefits provided by PNC to its employees;

- PNC s agreement to provide certain severance benefits to Mercantile employees for the one-year period after closing of the merger; and

- PNC s agreement to appoint two individuals mutually agreed by Mercantile and PNC to PNC s board of directors at closing.

The board of directors also considered potentially adverse factors and risks in reaching its conclusion, including:

Mercantile s history and heritage and the potential, impact on the greater Baltimore community of the loss of a leading independent regional bank.

The terms and conditions of the merger agreement, including:

- the termination fee of up to $225 million that Mercantile would be required to pay if the merger agreement is terminated under certain circumstances;

- the restrictions imposed on Mercantile from soliciting alternative transactions and the inability of Mercantile to terminate the merger agreement in order to accept an alternative proposal;

- the fact that Mercantile s board of directors may withdraw, modify or condition its recommendation that Mercantile s stockholders approve the merger only if the board determines, after consultation with its outside financial and legal advisors, that the failure to take such action would be inconsistent with its fiduciary obligations under applicable law; and

- the requirement that Mercantile must submit the merger agreement to a vote of Mercantile s stockholders notwithstanding any withdrawal or modification of the board of director s recommendation that Mercantile s stockholders approve the merger.

The complexity and risks involved in successfully integrating Mercantile and PNC in a timely manner, and the potential impact of integration on various constituencies.

The taxable nature for U.S. federal income tax purposes of the cash portion of the merger consideration received by Mercantile stockholders.

The fact that the interests of certain of Mercantile s officers and directors may be said to be different from, or in addition to, the interests of stockholders generally.

The above discussion of the information and factors considered by Mercantile s board of directors is not intended to be exhaustive, but indicates the material matters considered by the board of directors. In reaching its determination to approve the merger agreement and the transactions which it contemplates, the board did not quantify, rank or assign any relative or specific weight to, the foregoing factors, and individual directors may have considered various factors differently and may have given differing weights to different factors. Mercantile s board of directors did not undertake to make any specific determination as to whether any factor, or any particular aspect of any factor, supported or did not support its ultimate determination. Mercantile s board of directors based its determination on the totality of the information presented.

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Mercantile s board of directors determined, by unanimous vote of all directors present in person or by telephone at the meeting of the board of directors, that the merger on the terms and conditions set forth in the merger agreement is advisable and in the best interests of Mercantile and its stockholders. Accordingly, Mercantile s board of directors, by unanimous vote of all directors present in person or by telephone at the meeting of the board of directors, approved and adopted the merger agreement and the transactions contemplated thereby, and recommends that Mercantile stockholders vote FOR the proposal to approve the merger agreement.

Opinion of Mercantile s Financial Advisor

By letter dated October 3, 2006 Mercantile retained Sandler O Neill to act as its financial advisor in connection with a possible business combination with another financial institution. Sandler O Neill is a nationally recognized investment banking firm whose principal business specialty is financial institutions. In the ordinary course of its investment banking business, Sandler O Neill is regularly engaged in the valuation of financial institutions and their securities in connection with mergers and acquisitions and other corporate transactions.

Sandler O Neill acted as financial advisor to Mercantile in connection with the proposed merger and participated in certain of the negotiations leading to the execution of the merger agreement. At the October 8, 2006 meeting at which Mercantile s board of directors considered and approved the merger agreement, Sandler O Neill delivered to the board its oral opinion, subsequently confirmed in writing that, as of such date, the consideration to be received in the transaction was fair to Mercantile s shareholders from a financial point of view. **The full text of Sandler O Neill s opinion is attached as Annex B to this proxy statement/prospectus. The opinion outlines the procedures followed, assumptions made, matters considered and qualifications and limitations on the review undertaken by Sandler O Neill in rendering its opinion. The description of the opinion set forth below is qualified in its entirety by reference to the opinion. We urge Mercantile shareholders to read the entire opinion carefully in connection with their consideration of the proposed merger.**

Sandler O Neill s opinion speaks only as of the date of the opinion. The opinion was directed to the Mercantile board and is directed only to the fairness of the merger consideration to Mercantile shareholders from a financial point of view. It does not address the underlying business decision of Mercantile to engage in the merger or any other aspect of the merger and is not a recommendation to any Mercantile shareholder as to how such shareholder should vote at the special meeting with respect to the merger or any other matter.

In connection with rendering its October 8, 2006 opinion, Sandler O Neill reviewed and considered, among other things:

(1) the Agreement;

(2) certain publicly available financial statements and other historical financial information of Mercantile that Sandler O Neill deemed relevant;

(3) certain publicly available financial statements and other historical financial information of PNC that Sandler O Neill deemed relevant;

(4) consensus median earnings per share estimates for the years ending December 31, 2006 and 2007 published by Institutional Brokers Estimate System (I/B/E/S) and reviewed with management of Mercantile;

(5) consensus median earnings per share estimates for PNC for the years ending December 31, 2006 and 2007 published by I/B/E/S and reviewed with management of PNC;

(6) the pro forma financial impact of the Merger on PNC, based on assumptions relating to transaction expenses, purchase accounting adjustments, cost savings and other synergies determined by the senior management of PNC and as discussed with the senior management of Mercantile and PNC;

(7) publicly reported historical price and trading activity for the common stock of Mercantile and PNC, including a comparison of certain financial and stock market information for Mercantile and PNC with similar publicly available information for certain other companies the securities of which are publicly traded;

(8) to the extent publicly available, the financial terms of certain recent business combinations in the commercial banking industry;

(9) certain information concerning PNC, its business, financial condition, results of operations and prospects shared with Sandler O Neill in discussions with members of senior management of PNC;

(10) the current market environment generally and the banking environment in particular; and such other information, financial studies, analyses and investigations and financial, economic and market criteria as Sandler O Neill considered relevant.

Sandler O Neill also discussed with certain members of senior management of Mercantile the business, financial condition, results of operations and prospects of Mercantile and held similar discussions with certain members of management of PNC regarding the business, financial condition, results of operations and prospects of PNC.

In performing its reviews and analyses and in rendering its opinion, Sandler O Neill assumed and relied upon the accuracy and completeness of all the financial information, analyses and other information that was publicly available or otherwise provided to Sandler O Neill by Mercantile or PNC and further relied on the assurances of management of Mercantile and PNC that they were not aware of any facts or circumstances that would make such information inaccurate or misleading. Sandler O Neill was not asked to and did not independently verify the accuracy or completeness of any of such information and they did not assume any responsibility or liability for the accuracy or completeness of any of such information. Sandler O Neill did not make an independent evaluation or appraisal of the assets, the collateral securing assets or the liabilities, contingent or otherwise, of Mercantile or PNC or any of their respective subsidiaries, or the collectibility of any such assets, nor was it furnished with any such evaluations or appraisals. Sandler O Neill is not an expert in the evaluation of allowances for loan losses and it did not make an independent evaluation of the adequacy of the allowance for loan losses of Mercantile or PNC, nor did it review any individual credit files relating to Mercantile or PNC. With Mercantile s consent, Sandler O Neill assumed that the respective allowances for loan losses for both Mercantile and PNC were adequate to cover such losses.

Sandler O Neill s opinion was necessarily based upon market, economic and other conditions as they existed on, and could be evaluated as of, the date of its opinion. Sandler O Neill assumed, in all respects material to its analysis, that all of the representations and warranties contained in the merger agreement and all related agreements are true and correct, that each party to such agreements will perform all of the covenants required to be performed by such party under such agreements and that the conditions precedent in the merger agreement are not waived. Sandler O Neill also assumed, with Mercantile s consent, that there has been no material change in Mercantile s and PNC s assets, financial condition, results of operations, business or prospects since the date of the last financial statements made available to it that Mercantile and PNC will remain as going concerns for all periods relevant to its analyses, and that the merger will qualify as a tax-free reorganization for U.S. federal income tax purposes. Finally, with Mercantile s consent, Sandler O Neill relied upon the advice that Mercantile received from its legal and tax advisors as to all legal and tax matters relating to the Merger and the other transactions contemplated by the merger agreement.

In rendering its October 8, 2006 opinion, Sandler O Neill performed a variety of financial analyses. The following is a summary of the material analyses performed by Sandler O Neill, but is not a complete description of all the analyses underlying Sandler O Neill s opinion. The summary includes information presented in tabular format. **In order to fully understand the financial analyses, these tables must be read together with the accompanying text. The tables alone do not constitute a complete description of the financial analyses**. The preparation of a fairness opinion is a complex process involving subjective judgments as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances. The process, therefore, is not necessarily susceptible to a partial analysis or summary description. Sandler O Neill believes that its analyses must be considered as a whole and that selecting portions of the factors and analyses considered without considering all factors and analyses, or attempting to ascribe relative weights to some or all such factors and analyses, could create an incomplete view of the evaluation process underlying its opinion. Also, no company included in Sandler O Neill s comparative analyses described below is identical to Mercantile or PNC and no transaction is identical to the merger. Accordingly, an analysis of comparable companies or transactions involves complex considerations and judgments concerning differences in financial and operating characteristics of the companies and other factors that could affect the public trading values or merger transaction values, as the case may be, of Mercantile or PNC and the companies to which they are being compared.

The earnings projections used and relied upon by Sandler O Neill in its analyses were the publicly available I/B/E/S estimates for Mercantile and PNC, which were discussed with management of Mercantile and PNC, respectively. These earnings estimates and all projections of transaction costs, purchase accounting adjustments and expected cost savings relating to the merger were reviewed with the senior managements of PNC and Mercantile. Sandler O Neill expressed no opinion as to such financial projections or the assumptions on which they were based. These projections, as well as the other estimates used by Sandler O Neill in its analyses, were based on numerous variables and assumptions which are inherently uncertain and, accordingly, actual results could vary materially from those set forth in such projections.

In performing its analyses, Sandler O Neill also made numerous assumptions with respect to industry performance, business and economic conditions and various other matters, many of which cannot be predicted and are beyond the control of Mercantile, PNC and Sandler O Neill. The analyses performed by Sandler O Neill are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than suggested by such analyses. Sandler O Neill prepared its analyses solely for purposes of rendering its opinion and provided such analyses to the Mercantile board at its October 8, 2006 meeting. Estimates on the values of companies do not purport to be appraisals or necessarily reflect the prices at which companies or their securities may actually be sold. Such estimates are inherently subject to uncertainty and actual values may be materially different. Accordingly, Sandler O Neill s analyses do not necessarily reflect the value of Mercantile s common stock or PNC s common stock or the prices at which Mercantile s or PNC s common stock may be sold at any time.

Summary of the Transaction. Sandler O Neill reviewed the financial terms of the transaction. Based upon the ten-day average closing price of PNC s common stock on October 6, 2006 of $73.01 per share, the exchange ratio of 0.4184 and the cash payment of $16.45, and based upon per-share financial information for Mercantile for the twelve months ended June 30, 2006 with balance sheet related adjustments made for the then pending acquisition of James Monroe Bancorp (James Monroe), which closed on July 17, 2006, Sandler O Neill calculated the following ratios:

Transaction Ratios

Transaction value/Last 12 months Earnings Per Share	20.2x
Transaction value/Estimated 2006 Earnings Per Share	19.8x
Transaction value/Estimated 2007 Earnings Per Share	18.4x
Transaction value/Tangible book value per share	391%
Tangible book premium/Core deposits[1]	40.8%

[1] Assumes Mercantile s total core deposits are $10.9 billion. Excludes certificates of deposit greater than $100,000.

The aggregate transaction value was calculated by Sandler O Neill to be approximately $5.961 billion, based upon 125,474,855 shares of Mercantile common stock outstanding and including the intrinsic value of

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options to purchase an aggregate of 3,259,612 shares with a weighted average strike price of $27.46 per share. Sandler O Neill noted that the transaction value represented a 27.8% premium over the October 6, 2006 closing value of Mercantile s common stock.

Sandler O Neill reviewed, in addition to the financial terms of the transaction ratios, the effect of a change in PNC s stock price to the common stock consideration paid to Mercantile. Applying a range of PNC stock prices of $63.00 to $83.00 (in $2.00 increments), with a fixed cash consideration of $16.45 per share, it was noted that the total per share consideration would range from $42.81 to $51.18. This per share consideration range resulted in an aggregate transaction value range of $5.421 billion to $6.499 billion, based upon 125,474,855 shares of Mercantile common stock outstanding and including the intrinsic value of options to purchase an aggregate of 3,259,612 shares with a weighted average strike price of $27.46 per option. Sandler O Neill calculated the following transaction values and transaction ratios:

										Transaction Multiples		
Buyer s Stock Price	% Change in Stock Price	Offer Price Per Share	Stock Portion Per Share	% Value Stock	Cash Portion Per Share	% Value Cash	Intrinsic Value Options ($mm)	Aggregate Value ($mm)	% Change in Aggregate Value ($mm)	Price/ LTM EPS (x)	Price/ TBV (%)	Premium to Core Deposits (%)
$83.00	13.7%	$ 51.18	$ 34.73	67.9%	$ 16.45	32.1%	$ 77.3	$ 6,499	9.0%	22.0x	426%	45.7%
$81.00	10.9%	$ 50.34	$ 33.89	67.3%	$ 16.45	32.7%	$ 74.6	$ 6,391	7.2%	21.6x	419%	44.7%
$79.00	8.2%	$ 49.50	$ 33.05	66.8%	$ 16.45	33.2%	$ 71.8	$ 6,283	5.4%	21.2x	412%	43.8%
$77.00	5.5%	$ 48.67	$ 32.22	66.2%	$ 16.45	33.8%	$ 69.1	$ 6,176	3.6%	20.9x	405%	42.8%
$75.00	2.7%	$ 47.83	$ 31.38	65.6%	$ 16.45	34.4%	$ 66.4	$ 6,068	1.8%	20.5x	398%	41.8%
$73.01	0.0%	$ 47.00	$ 30.55	65.0%	$ 16.45	35.0%	$ 63.7	$ 5,961	0.0%	20.2x	391%	40.8%
$71.00	(2.8)%	$ 46.16	$ 29.71	64.4%	$ 16.45	35.6%	$ 60.9	$ 5,852	(1.8)%	19.8x	384%	39.8%
$69.00	(5.5)%	$ 45.32	$ 28.87	63.7%	$ 16.45	36.3%	$ 58.2	$ 5,745	(3.6)%	19.5x	377%	38.8%
$67.00	(8.2)%	$ 44.48	$ 28.03	63.0%	$ 16.45	37.0%	$ 55.5	$ 5,637	(5.4)%	19.1x	370%	37.8%
$65.00	(11.0)%	$ 43.65	$ 27.20	62.3%	$ 16.45	37.7%	$ 52.7	$ 5,529	(7.2)%	18.7x	363%	36.8%
$63.00	(13.7)%	$ 42.81	$ 26.36	61.6%	$ 16.45	38.4%	$ 50.0	$ 5,421	(9.0)%	18.4x	356%	35.9%

***Stock Trading History*.** Sandler O Neill reviewed the history of the reported trading prices and volume of Mercantile s and PNC s common stock for the one-year and three-year periods ended October 6, 2006. As described below, Sandler O Neill then compared the relationship between the movements in the prices of Mercantile s and PNC s common stock to movements in the prices of the NASDAQ Bank Index, the S&P 500 Index, and the S&P Bank Index. During the one year period ended October 6, 2006, Mercantile underperformed each of the indices to which it was compared. During the three-year period ended the same day, Mercantile outperformed each of the indices to which it was compared.

Mercantile s Stock Performance

	Beginning Index Value October 6, 2005	Ending Index Value October 6, 2006
Mercantile	100.0%	104.5%
NASDAQ Bank Index	100.0	111.7
S&P 500 Index	100.0	113.3
S&P Bank Index	100.0	118.8

	Beginning Index Value October 6, 2003	Ending Index Value October 7, 2006
Mercantile	100.0%	135.5%
NASDAQ Bank Index	100.0	121.3
S&P 500 Index	100.0	130.5
S&P Bank Index	100.0	130.6

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During the one-year period and the three-year period ended October 6, 2006, PNC generally outperformed each of the indices to which it was compared.

PNC s Stock Performance

	Beginning Index Value October 6, 2005	Ending Index Value October 6, 2006
PNC	100.0%	129.6%
NASDAQ Bank Index	100.0	111.7
S&P 500 Index	100.0	113.3
S&P Bank Index	100.0	118.8

	Beginning Index Value October 6, 2003	Ending Index Value October 7, 2006
PNC	100.0%	149.4%
NASDAQ Bank Index	100.0	121.3
S&P 500 Index	100.0	130.5
S&P Bank Index	100.0	130.6

***Comparable Company Analysis*.** Sandler O Neill used publicly available information to compare selected financial and market trading information for Mercantile and PNC with groups of financial institutions selected by Sandler O Neill for Mercantile and PNC, respectively. For Mercantile, the peer groups consisted of the following: (1) a Nationwide Regional Comparable Group consisting of publicly traded regional banking institutions each having a market capitalization greater than $1.9 billion as of October 6, 2006 and (2) a Mid-Atlantic Comparable Group consisting of publicly traded Mid-Atlantic banking institutions each having a market capitalization greater than $700 million as of October 6, 2006.

Mercantile Nationwide Regional Comparable Group

Zions Bancorporation	Cullen/Frost Bankers, Inc.
Compass Bancshares, Inc.	City National Corporation
Commerce Bancorp, Inc.	Valley National Bancorp
Colonial BancGroup, Inc.	South Financial Group, Inc.
Commerce Bancshares, Inc.	

Mercantile Mid-Atlantic Comparable Group

Wilmington Trust Corporation	Fulton Financial Corporation
Webster Financial Corporation	United Bankshares, Inc.
Susquehanna Bancshares, Inc.	Provident Bankshares Corporation
First Charter Corporation	

The analysis compared publicly available financial information for Mercantile as of and for the twelve months ended June 30, 2006 with that of the Mercantile peer group as of and for the twelve month period ended June 30, 2006. The table below sets forth the data for Mercantile and the median data for the Mercantile peer groups, with pricing data as of October 6, 2006.

Comparable Group Analysis

	Mercantile	Mercantile Nationwide Regional Comparable Group	Mercantile Mid-Atlantic Comparable Group
Market Capitalization ($mm)	$ 4,615	$ 3,314	$ 1,565
Price/tangible book value per share	306%	292%	335%
Price/2006 Estimated Earnings per share[1]	15.5x	15.9x	15.2x
Price/2007 Estimated Earnings per share[2]	14.4x	14.5x	14.3x
I/B/E/S long-term growth	9.0%	10.0%	8.5%
2007 Price/Earnings to Growth	1.6x	1.4x	1.7x
Premium to Core Deposits	28.5%	20.9%	22.2%

[1] Based upon publicly available median I/B/E/S estimates for the year ending December 31, 2006 for Mercantile, which was discussed with management of Mercantile.

[2] Based upon publicly available median I/B/E/S estimates for the year ending December 31, 2007 for Mercantile, which was discussed with management of Mercantile.

PNC Nationwide Comparable Group

Wells Fargo & Company
U.S. Bancorp
Bank of New York Company, Inc.
National City Corporation
KeyCorp
Wachovia Corporation
SunTrust Banks, Inc.
BB&T Corporation
Fifth Third Bancorp

The analysis compared publicly available financial information for PNC with that of each of the companies in the PNC peer groups as of and for the twelve months ended June 30, 2006. The table below sets forth the data for PNC and the median data for the PNC peer groups, with pricing data as of October 6, 2006.

	PNC	PNC Nationwide Peer Group
Market Capitalization ($mm)	$ 21,690	$ 27,366
Price/tangible book value per share	318%	396%
Price/2006 Estimated Earnings per share[1]	14.6x	13.2x
Price/2007 Estimated Earnings per share[2]	13.0x	12.1x
I/B/E/S long-term growth	9.3%	9.5%
2007 Price/Earnings to Growth	1.4x	1.3x
Premium to Core Deposits	26.7%	28.9%

[1] Based upon publicly available median I/B/E/S estimates for the year ending December 31, 2006 for PNC, which was discussed with management of PNC.

[2] Based upon publicly available median I/B/E/S estimates for the year ending December 31, 2007 for PNC, which was discussed with management of PNC.

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***Analyst Recommendation and Estimates Analysis*.** Sandler O Neill used publicly available I/B/E/S research analyst estimates and recommendations to outline the current analyst views for Mercantile and PNC respectively. For Mercantile, the analysts consisted of the following:

Firms with Published Mercantile Research

BB&T Capital Markets	KeyBanc Capital Markets
Credit Suisse	Lehman Brothers Inc.
Davenport & Company	Merrill Lynch & Co.
Ferris Baker Watts Inc.	Miller Tabak & Co.
FIG Partners LLC	Prudential Equity Group LLC
Fox-Pitt Kelton Inc.	RBC Capital Markets
Friedman Billings Ramsey & Co.	Ryan Beck & Co.
FTN Midwest	Stifel Nicolaus & Co.
J.J.B. Hilliard W. L. Lyons	Sturdivant & Co.
Keefe Bruyette & Woods Inc.	SunTrust Robinson Humphrey

The analysis compared published recommendations, price targets, long term growth rates, 2006 earnings per share estimates and 2007 earnings per share estimates. As of October 6, 2006 seventeen research analysts had published recommendations for Mercantile, composed of thirteen Hold recommendations, one Sell recommendation and three Buy recommendations. The table below sets forth the median I/B/E/S published estimates and price targets for Mercantile as of October 6, 2006.

	Mercantile
Target Price ($)	$ 39.00
I/B/E/S Long Term Growth Rate	9.00%
I/B/E/S 2006 Estimated Earnings per share	$ 2.37
I/B/E/S 2007 Estimated Earnings per share	$ 2.56

For PNC, the analysts consisted of the following:

Firms with Published PNC Research

A.G. Edwards Inc.	Merrill Lynch & Co.
Banc of America Securities	Morgan Stanley
Bear, Stearns & Company	NAB Research LLC
CIBC World Markets Corporation	Oppenheimer & Co.
Citigroup Investment Research	Prudential Equity Group LLC
Fox-Pitt Kelton Inc.	Punk Ziegel & Co.
Friedman Billings Ramsey & Co.	RBC Capital Markets
Goldman, Sachs & Co.	Sandler O Neill & Partners LP
Keefe Bruyette & Woods Inc.	Sanford C. Bernstein & Co. LLC
Lehman Brothers, Inc.	UBS Securities LLC

The analysis compared published recommendations, price targets, long term growth rates, 2006 earnings per share estimates and 2007 earnings per share estimates. As of October 6, 2006 nineteen research analysts had published recommendations for PNC, composed of eleven Hold recommendations and eight Buy recommendations. The table below sets forth the median I/B/E/S published estimates and price targets for PNC as of October 6, 2006.

	PNC
Target Price ($)	$ 77.50

I/B/E/S Long Term Growth Rate	9.25%
I/B/E/S 2006 Estimated Earnings per share	$ 5.05
I/B/E/S 2007 Estimated Earnings per share	$ 5.67

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Analysis of Selected Merger Transactions**.** Sandler O Neill reviewed 21 merger transactions announced nationwide from January 1, 2001 through October 6, 2006 involving the acquisitions of commercial banking institutions with announced transaction values greater than $1 billion. Sandler O Neill reviewed the multiples of transaction price at announcement to last twelve months earnings, transaction price to this year s estimated earnings, transaction price to tangible book value, tangible book premium to core deposits, and premium to market value. The median multiples from this nationwide group was compared to the proposed transaction ratios.

Comparable Transaction Metrics

	PNC/Mercantile Metric	Median Nationwide Metric
Transaction price/Last twelve months earnings per share	20.2x	19.2x
Transaction price/Estimated 2006 earnings per share	19.8x	17.4x
Transaction price/Tangible book value	391%	364%
Tangible book premium/Core deposits[1]	40.8%	27.3%
Market Premium[2]	27.8%	24.3%

[1] Assumes Mercantile s core deposits total $10.9 billion.

[2] Based on Mercantile s closing price of $36.78 per share as of October 6, 2006.

Discounted Cash Flow Analysis**.** Sandler O Neill performed an analysis that estimated the future stream of after-tax cash flows of Mercantile through December 31, 2011 under various circumstances, assuming Mercantile s core dividend payout ratio of 47.3% and that Mercantile performed in accordance with the earnings and growth projections reviewed with management of Mercantile. To approximate the terminal value of Mercantile common stock at December 31, 2011, Sandler O Neill applied price to earnings multiples ranging from 13x to 16x. The dividend income streams and terminal values were then discounted to present values using different discount rates ranging from 10.0% to 13.0% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of Mercantile common stock. In addition, the terminal value of Mercantile s common stock at December 31, 2011 was calculated using a 14x price to last twelve months earnings multiple applied to a range of discounts and premiums to the projected net income of Mercantile. The range applied to the projected net income was 10% under the projected amount to 10% over the projected amount, using a range of discount rates from 10.0% to 13.0% for the tabular analysis. As illustrated in the following tables, this analysis indicated an imputed range of values per share for Mercantile s common stock of $37.29 to $48.11 when applying the price to earnings multiples to the matched projections and $35.45 to $47.99 when applying the discount rates and a 14x price to earnings multiples to the -10% / +10% projection.

	Earnings Per Share Multiples			
	13.0x	**14.0x**	**15.0x**	**16.0x**
10.0%	$ 41.65	$ 43.80	$ 45.96	$ 48.11
11.0%	$ 40.12	$ 42.17	$ 44.23	$ 46.28
12.0%	$ 38.66	$ 40.62	$ 42.58	$ 44.54
13.0%	$ 37.29	$ 39.16	$ 41.03	$ 42.90

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With Projected Net Income Variance:

	Discount Rates			
	10.0%	11.0%	12.0%	13.0%
10.00%	$ 47.99	$ 46.19	$ 44.48	$ 42.86
8.00%	$ 47.15	$ 45.38	$ 43.71	$ 42.12
6.00%	$ 46.31	$ 44.58	$ 42.94	$ 41.38
4.00%	$ 45.48	$ 43.78	$ 42.17	$ 40.64
2.00%	$ 44.64	$ 42.97	$ 41.40	$ 39.90
0.00%	$ 43.80	$ 42.17	$ 40.62	$ 39.16
(2.00)%	$ 42.97	$ 41.37	$ 39.85	$ 38.42
(4.00)%	$ 42.13	$ 40.56	$ 39.08	$ 37.68
(6.00)%	$ 41.29	$ 39.76	$ 38.31	$ 36.93
(8.00)%	$ 40.45	$ 38.96	$ 37.54	$ 36.19
(10.00)%	$ 39.62	$ 38.15	$ 36.77	$ 35.45

In connection with its analyses, Sandler O Neill considered and discussed with the Mercantile board of directors how the present value analyses would be affected by changes in the underlying assumptions, including variations with respect to net income. Sandler O Neill noted that the discounted cash flow and terminal value analysis is a widely used valuation methodology, but the results of such methodology are highly dependent upon the numerous assumptions that must be made, and the results thereof are not necessarily indicative of actual values or future results.

Sandler O Neill performed an analysis that estimated the future stream of after-tax cash flows of PNC through December 31, 2011 under various circumstances, assuming PNC s core dividend payout ratio of 43.6% and that PNC performed in accordance with the earnings and growth projections reviewed with and confirmed by management of PNC. To approximate the terminal value of PNC common stock at December 31, 2011, Sandler O Neill applied price to earnings multiples ranging from 12x to 15x. The dividend income streams and terminal values were then discounted to present values using different discount rates ranging from 11.0% to 14.0% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of PNC common stock. In addition, the terminal value of PNC s common stock at December 31, 2011 was calculated using a 13x price to last twelve months earnings multiple applied to a range of discounts and premiums to the projected net income of PNC. The range applied to the projected net income was 10% under the projected amount to 10% over the projected amount, using a range of discount rates from 11.0% to 14.0% for the tabular analysis. As illustrated in the following tables, this analysis indicated an imputed range of values per share for PNC s common stock of $69.79 to $91.00 when applying the price to earnings multiples to the matched projections and $66.52 to $90.25 when applying the discount rates and a 13x price to earnings multiples to the -10% / +10% projection.

	Earnings Per Share Multiples			
	12.0x	13.0x	14.0x	15.0x
11.0%	$ 77.93	$ 82.29	$ 86.64	$ 91.00
12.0%	$ 75.07	$ 79.23	$ 83.39	$ 87.55
13.0%	$ 72.36	$ 76.33	$ 80.30	$ 84.27
14.0%	$ 69.79	$ 73.58	$ 77.37	$ 81.16

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With Projected Net Income Variance:

	Discount Rates			
	11.0%	**12.0%**	**13.0%**	**14.0%**
10.00%	$ 90.25	$ 86.88	$ 83.68	$ 80.65
8.00%	$ 88.66	$ 85.35	$ 82.21	$ 79.23
6.00%	$ 87.06	$ 83.82	$ 80.74	$ 77.82
4.00%	$ 85.47	$ 82.29	$ 79.27	$ 76.41
2.00%	$ 83.88	$ 80.76	$ 77.80	$ 75.00
0.00%	$ 82.29	$ 79.23	$ 76.33	$ 73.58
(2.00)%	$ 80.69	$ 77.70	$ 74.86	$ 72.17
(4.00)%	$ 79.10	$ 76.17	$ 73.39	$ 70.76
(6.00)%	$ 77.51	$ 74.64	$ 71.92	$ 69.35
(8.00)%	$ 75.92	$ 73.11	$ 70.45	$ 67.93
(10.00)%	$ 74.32	$ 71.58	$ 68.99	$ 66.52

In connection with its analyses, Sandler O Neill considered and discussed with the Mercantile board of directors how the present value analyses would be affected by changes in the underlying assumptions, including variations with respect to net income. Sandler O Neill noted that the discounted cash flow and terminal value analysis is a widely used valuation methodology, but the results of such methodology are highly dependent upon the numerous assumptions that must be made, and the results thereof are not necessarily indicative of actual values or future results.

Pro Forma Merger Analysis**.** Sandler O Neill analyzed certain potential pro forma effects of the merger, assuming the following: (1) the merger closes on March 1, 2007; (2) 100% of the Mercantile shares are exchanged for shares of PNC common stock and cash at total price per share of $47.00 dollars; (3) I/B/E/S median earnings per share estimates for 2006 and 2007 of $5.05 and $5.67 for PNC, respectively, and $2.37 and $2.56 for Mercantile, respectively; (4) 2008 earnings per share estimates are derived using the median I/B/E/S long-term growth rates for each company applied to the 2007 I/B/E/S median earnings per share estimate; (5) no purchase accounting adjustments related to securities; (6) 25% cost saves on Mercantile s non-interest expense base or $108 million plus an additional $27 million in savings attributable to PNC s initiatives, 33% of which is phased in 2007 and 100% of which is phased in 2008; (7) 5.75% pre-tax cost of cash used to fund the deal; (8) after-tax restructuring charges of $97.2 million capitalized at close and $44.5 million deduction to net income in 2007; (9) 3.6% core deposit intangible amortized over 10 years using sum of years digits methodology; (10) tax rate of 37.7%; (11) no deposit divestitures; and (12) PNC will repurchase shares of PNC common stock with the goal of managing its tangible common equity to tangible asset ratio to approximately 5.5%.

Based upon those assumptions, Sandler O Neill s analysis indicated that during the years ended December 31, 2007 and December 31, 2008 the merger would be dilutive to PNC s earnings per share in 2007, accretive to PNC s earnings per share in 2008, dilutive to PNC s cash earnings per share in 2007, and accretive to PNC s cash earnings per share in 2008.

From the perspective of a Mercantile shareholder, the analysis indicated that at the years ended December 31, 2007 and December 31, 2008, the merger would be accretive to Mercantile s earnings per share, dilutive to Mercantile s tangible book value per share and accretive to Mercantile s dividends per share. The actual results achieved by the combined company may vary from projected results and the variations may be material.

Sandler O Neill Relationship**.** Mercantile has agreed to pay Sandler O Neill a transaction fee in connection with the merger of approximately $18,000,000 of which $5,000,000 has been paid and the balance of which is contingent, and payable, upon closing of the merger. Sandler O Neill has also received a fee of $1,000,000, as part of the transaction fee already paid, for rendering its opinion, which will be credited against that portion of the transaction fee due upon closing of the merger. Mercantile has also agreed to reimburse certain of Sandler O Neill s reasonable out-of-pocket expenses incurred in connection with its engagement and to indemnify Sandler O Neill and its affiliates and their respective partners, directors, officers, employees, agents, and controlling persons against certain expenses and liabilities, including liabilities under securities laws.

Sandler O Neill has, in the past, provided certain investment banking services to both Mercantile and PNC and has received compensation for such services. In the ordinary course of its business as a broker-dealer, Sandler O Neill may purchase securities from and sell securities to Mercantile and PNC and their affiliates. Sandler O Neill may also actively trade the debt or equity securities of Mercantile and/or PNC or their affiliates for its own account and for the accounts of its customers and, accordingly, may at any time hold a long or short position in such securities.

Board of Directors and Management of PNC Following Completion of the Merger

Upon completion of the merger, the current directors and officers of PNC are expected to continue in their current positions. Two additional directors will be added to PNC s board of directors, with the additional directors to be mutually agreed upon by Mercantile and PNC.

Information about the current PNC directors and executive officers can be found in PNC s proxy statement dated March 24, 2006. Information about the current Mercantile directors and executive officers can be found in Mercantile s proxy statement dated March 29, 2006. PNC s and Mercantile s Annual Reports on Form 10-K for the year ended December 31, 2005 are incorporated by reference in this document. See Where You Can Find More Information on page [ ].

For more information see Mercantile s Directors and Officers Have Financial Interests in the Merger on page [ ].

Public Trading Markets

PNC common stock trades on the NYSE under the symbol PNC . Mercantile common stock trades on the NASDAQ under the symbol MRBK. Upon completion of the merger, Mercantile common stock will be delisted from the NASDAQ and deregistered under the Securities Exchange Act of 1934, as amended. The PNC common stock issuable in the merger will be listed on the NYSE.

The shares of PNC common stock to be issued in connection with the merger will be freely transferable under the Securities Act of 1933, as amended, which we refer to as the Securities Act, except for shares issued to any stockholder who is an affiliate of Mercantile, as discussed in The Merger Agreement Resales of PNC Stock by Affiliates on page [ ].

Mercantile Stockholders Do Not Have Dissenters Appraisal Rights in the Merger

Appraisal rights are statutory rights that allow stockholders to dissent from extraordinary transactions, such as a merger, and to demand that the corporation pay the fair value of their shares as determined by a court in a judicial proceeding instead of receiving the consideration offered to stockholders in connection with the extraordinary transaction. Appraisal rights are not available in all circumstances, and exceptions to these rights are provided under the Maryland General Corporation Law. Because Mercantile common stock is listed on the NASDAQ, the holders of Mercantile common stock are not entitled to appraisal rights in the merger.

Regulatory Approvals Required for the Merger

We have agreed to use our reasonable best efforts to obtain all regulatory approvals required to complete the transactions contemplated by the merger agreement. These approvals include approval from the Federal Reserve Board, the Delaware State Bank Commissioner, the Commissioner of Financial Regulation of the Maryland

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Department of Labor, Licensing and Regulation and the Bureau of Financial Institutions of the Virginia State Corporation Commission, as well as various other federal and state regulatory authorities. PNC and Mercantile have completed, or will complete, the filing of applications and notifications to obtain the required regulatory approvals.

Federal Reserve Board. The merger is subject to approval by the Federal Reserve Board pursuant to Section 3 of the Bank Holding Company Act of 1956. On November 22, 2006, PNC filed the required application with the Federal Reserve Board for approval of the merger.

The Federal Reserve Board is prohibited from approving any transaction under the applicable statutes that (1) would result in a monopoly, (2) would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or (3) may have the effect in any section of the United States of substantially lessening competition, tending to create a monopoly or resulting in a restraint of trade, unless the Federal Reserve Board finds that the anti-competitive effects of the transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the communities to be served. The Federal Reserve Board may not approve an interstate acquisition without regard to state law if the applicant controls, or after completion of the acquisition the combined entity would control, more than 10 percent of the total deposits of insured depository institutions in the United States.

In addition, in reviewing a transaction under the applicable statutes, the Federal Reserve Board will consider the financial and managerial resources of the companies and their subsidiary banks and the convenience and needs of the community to be served as well as the companies effectiveness in combating money-laundering activities. In connection with its review, the Federal Reserve Board will provide an opportunity for public comment on the application for the merger, and is authorized to hold a public meeting or other proceeding if it determines that would be appropriate.

Under the Community Reinvestment Act of 1977, which we refer to as the CRA, the Federal Reserve Board must take into account the record of performance of each of PNC and Mercantile in meeting the credit needs of the entire communities, including low- and moderate-income neighborhoods, served by the company and its subsidiaries. Each of PNC s and Mercantile s depository institutions has a satisfactory or better CRA rating.

Other Requisite Approvals, Notices and Consents. The merger is also subject to the prior approval of the Delaware State Bank Commissioner, the Commissioner of Financial Regulation of the Maryland Department of Labor, Licensing and Regulation and the Bureau of Financial Institutions of the Virginia State Corporation Commission. Applications or notifications may also be required to be filed with various other regulatory authorities in connection with the merger.

Antitrust Considerations. At any time before or after the acquisition is completed, the Antitrust Division of the United States Department of Justice or the United States Federal Trade Commission, which we refer to as the Antitrust Division and the FTC, respectively, could take action under the antitrust laws as it deems necessary or desirable in the public interest, including seeking to enjoin the acquisition or seeking divestiture of substantial assets of PNC or Mercantile or their subsidiaries. Private parties also may seek to take legal action under the antitrust laws under some circumstances. Based upon an examination of information available relating to the businesses in which the companies are engaged, PNC and Mercantile believe that the completion of the merger will not violate U.S. antitrust laws. However, PNC and Mercantile can give no assurance that a challenge to the merger on antitrust grounds will not be made, or, if such a challenge is made, that PNC and Mercantile will prevail.

In addition, the merger may be reviewed by the state attorneys general in the various states in which PNC and Mercantile operate. Although PNC and Mercantile believe there are substantial arguments to the contrary, these agencies may claim the authority, under the applicable state and federal antitrust laws and regulations, to investigate and/or disapprove the merger. There can be no assurance that one or more state attorneys general will not attempt to file an antitrust action to challenge the merger.

Timing. We cannot assure you that all of the regulatory approvals described above will be obtained, and, if obtained, we cannot assure you as to the date of any approvals or the absence of any litigation challenging such approvals. Likewise, we cannot assure you that the Antitrust Division, the FTC or any state attorney general will not attempt to challenge the merger on antitrust grounds, and, if such a challenge is made, we cannot assure you as to its result.

Pursuant to the Bank Holding Company Act, a transaction approved by the Federal Reserve Board may not be completed until 30 days after approval is received, during which time the Antitrust Division may challenge the merger on antitrust grounds. The commencement of an antitrust action would stay that is, suspend the effectiveness of an approval unless a court specifically were to order otherwise. With the approval of the Federal Reserve Board and the concurrence of the Antitrust Division, the waiting period may be reduced to no less than 15 days.

PNC and Mercantile believe that the merger does not raise substantial antitrust or other significant regulatory concerns and that they will be able to obtain all requisite regulatory approvals on a timely basis without the imposition of any condition that would have a material adverse effect on PNC or Mercantile. In connection with obtaining any required regulatory approvals, PNC is not required to agree to conditions or restrictions that would have a material adverse effect on either Mercantile or PNC, measured on a scale relative to Mercantile.

We are not aware of any material governmental approvals or actions that are required for completion of the merger other than those described above. It is presently contemplated that if any such additional governmental approvals or actions are required, those approvals or actions will be sought. There can be no assurance, however, that any additional approvals or actions will be obtained.

Mercantile s Directors and Officers Have Financial Interests in the Merger

In considering the recommendation of Mercantile s Board of Directors that Mercantile stockholders vote in favor of the proposal to approve the merger, Mercantile stockholders should be aware that Mercantile directors and executive officers may have interests in the merger that may be different from, or in addition to, their interests as stockholders of Mercantile. Mercantile s Board of Directors was aware of these interests and took them into account in its decision to approve the merger and the merger agreement. These interests relate to or arise from the following:

Executive Severance Agreements and Executive Employment Agreements

Mercantile and Mercantile-Safe Deposit and Trust Company have previously entered into Amended and Restated Executive Severance Agreements with Edward J. Kelly, III, Jay M. Wilson, Alexander T. Mason, J. Marshall Reid, Peter W. Floeckher, Jr. and 12 other executive officers of Mercantile.

Each of the severance agreements (except for the severance agreement with Mr. Kelly, as described below) provides that, upon a change in control (including completion of the merger) followed by (1) termination of employment other than for cause (as defined in the severance agreement), disability (as defined in the severance agreement), or death, or (2) termination by the executive for good reason (as defined in the severance agreement), within three years following the change in control, the executive will be entitled to a lump sum cash severance equal to three times the sum of (i) twelve times the average monthly base salary received by the executive during the thirty-six month period prior to termination of employment, plus (ii) the average annual bonuses earned by the executive for the three fiscal years preceding such termination; provided that if any alternate benefit in the form of continued or additional salary or bonus following termination of employment is provided for the executive under any applicable employment agreement, then the cash payment to the executive under the severance agreement shall be the greater of the alternate benefit or the change in control severance amount, and such payment shall satisfy Mercantile s obligations with respect to the alternate benefit. The severance agreements (except for that with Mr. Kelly, as described below) also provide for payment if the

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executive is terminated within 6 months before a change in control and can demonstrate that his termination (1) was at the request of a third party who had, at the time of such termination, taken steps reasonably calculated to effect the change in control, or (2) was solely the result of Mercantile s bad faith effort to avoid its obligations hereunder. Consummation of the merger would constitute a change in control under the severance agreements.

In 2006, Mr. Kelly s severance agreement was amended to eliminate the cash severance payment described in the preceding paragraph. In addition, in 2006 Mr. Kelly entered into an amendment to his employment agreement eliminating Mercantile s obligation to continue to provide all contractual benefits (including salary) through any remaining term of the agreement in the event of a termination of Mr. Kelly s employment without cause.

The severance agreements provide a gross up for tax liability, interest or penalties under Section 4999 or 409A of the Internal Revenue Code of 1986 (referred to herein as the Code), for any payments by Mercantile or Mercantile-Safe Deposit and Trust Company (whether under the severance agreements or otherwise), such that the executive receives a gross-up payment (net of income and excise taxes, and interest and penalties) sufficient to cover the tax liability, interest or penalties under Section 4999 or 409A of the Code. However, the severance agreements (except for Mr. Kelly s severance agreement) provide that if the executive s payments (under the severance agreements and otherwise) could avoid characterization as parachute payments under Section 280G of the Code if they were reduced by an amount not in excess of the lesser of (1) 10% of such payments or (2) $150,000, then the executive s payments (under the severance agreement) shall be reduced, but not below zero, to the maximum amount that can be paid without triggering the Section 4999 excise tax and no gross-up will be paid under the severance agreement.

The only executive officer who has an employment agreement containing severance provisions is Jay M. Wilson. Under the amended and restated executive employment agreement effective June 14, 2005 between Mercantile Bankshares Corporation and Mercantile-Safe Deposit and Trust Company and Jay M. Wilson, upon an involuntary termination of employment without good cause (as defined in the agreement) or upon a resignation for good reason (as defined in the agreement), whether or not in connection with a change in control, Mr. Wilson is entitled to receive: (1) any accrued compensation (as defined in the agreement); (2) continued payment of base salary for the remainder of the agreement term; (3) a bonus for the year of termination equal to the highest bonus for the immediately preceding three years; (4) full and immediate vesting of any stock options, restricted stock, stock appreciation rights, deferred compensation or other restricted benefits; and (5) continuing group health and group life insurance for Mr. Wilson and (if applicable) his spouse and eligible dependents for the remainder of the term of the agreement.

Bonus and Retention Payments

Subject to action of the Compensation Committee of Mercantile s Board of Directors, the merger agreement provides that Mercantile may pay bonuses or other retention payments in an aggregate amount of $39,000,000, which includes $14,000,000 that will have been accrued in respect of 2006 annual bonuses and an additional $25,000,000, all of which will be accrued or paid on or before the effective time of the merger. Out of this retention pool, annual bonuses in respect of 2006 will be paid to employees who have change in control agreements at 100% of the target amount on or before December 31, 2006. Annual 2006 bonuses for other employees will be paid at the earlier of the effective time of the merger or the date of regular bonus payments scheduled to be made in March 2007.

Options to Purchase Shares

The merger agreement provides that, upon completion of the merger, each outstanding option to purchase shares of Mercantile common stock granted under any stock compensation plan maintained by Mercantile or its subsidiaries, which we refer to as the Mercantile stock plans, to employees or directors of Mercantile or its subsidiaries, whether vested or not, will be cancelled in exchange for the right to receive a lump sum cash payment to be paid as soon as practicable after the completion of the merger. The lump sum cash payment shall equal the product of (i) the number of shares of Mercantile common stock subject to the outstanding portion of the option and (ii) the excess of the all cash consideration over the exercise price per share of the option. The all cash consideration will equal the sum of (a) $16.45 and (b) the product of 0.4184 multiplied by the average, rounded to the nearest one-ten thousandth, of the closing sale prices of PNC common stock for the five trading days immediately preceding the date of completion of the merger. The lump sum cash payment shall be subject to applicable tax withholding.

Stock options held by Mercantile s directors and executive officers as of the record date for the special meeting are shown in the following table:

	Outstanding Options	Weighted Average Exercise Price Per Share
Edward J. Kelly, III	[ ]	[ ]
Alexander T. Mason	[ ]	[ ]
Jay M. Wilson	[ ]	[ ]
J. Marshall Reid	[ ]	[ ]
Peter W. Floecker, Jr.	[ ]	[ ]
All other directors and executive officers as group	[ ]	[ ]

Restricted Stock and Restricted Stock Units

The merger agreement provides that, upon completion of the merger, each outstanding restricted share of Mercantile common stock and each outstanding restricted stock unit of Mercantile common stock granted under the Mercantile stock plans, regardless of whether or not vested, shall be cancelled and converted into the right to receive, without restrictions, the merger consideration, which is (a) 0.4184 of a share of PNC common stock and (b) cash equal to $16.45. PNC shall be entitled to deduct applicable tax withholding.

A restricted share is a share of Mercantile common stock that is forfeitable to Mercantile until certain restrictions lapse. A restricted stock unit is an agreement to issue a share of Mercantile common stock upon the satisfaction of certain conditions.

Restricted stock and restricted stock units held by Mercantile s directors and executive officers as of the record date for the special meeting are shown in the following table:

	Shares of Restricted Stock	Restricted Stock Units
Edward J. Kelly, III	[ ]	[ ]
Alexander T. Mason	[ ]	[ ]
Jay M. Wilson	[ ]	[ ]
J. Marshall Reid	[ ]	[ ]
Peter W. Floecker, Jr.	[ ]	[ ]
All other directors and executive officers as group	[ ]	[ ]

Phantom Stock Units

The merger agreement provides that, upon completion of the merger, each phantom stock unit with respect to Mercantile common stock granted under certain non-employee director deferred compensation plans shall cease to represent rights with respect to Mercantile common stock and shall be converted into, at the option of Mercantile, the all cash consideration or the merger consideration or phantom stock units with respect to an equivalent number of shares of PNC common stock. If the latter option is selected, the number of phantom stock units with respect to PNC common stock would equal the number of shares of Mercantile common stock subject to such phantom stock units multiplied by the sum of (a) $16.45 divided by the average, rounded to the nearest

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one-ten thousandth, of the closing sale prices of PNC common stock for the five trading days immediately preceding the date of the completion of the merger and (b) 0.4184.

The consideration for the phantom stock units as determined above would be payable on the same terms and conditions as were in effect immediately prior to the completion of the merger with any cash payment due to be paid as soon as reasonably practical after the completion of the merger at the option of Mercantile.

The number of phantom stock units held by the nonemployee directors as a group as of the record date for the special meeting are [ ].

Indemnification and Insurance

The merger agreement provides that (a) from and after the effective time of the merger, PNC shall, to the fullest extent permitted by applicable law, indemnify, defend and hold harmless, and provide advancement of expenses to, Mercantile s directors and officers against all losses, claims, damages, costs, expenses (including fees and expenses of counsel), fines, penalties, liabilities or judgments or amounts that are paid in settlement of or in connection with any claim based on or arising out of the fact that such person is or was a director or officer of Mercantile or a subsidiary of Mercantile, and pertaining to any matter existing or occurring, or any acts or omissions occurring, at or prior to the effective time of the merger and (b) all rights to indemnification and exculpation from liabilities for acts or omissions occurring at or prior to the effective time of the merger now existing in favor of any Mercantile director or officer as provided in the charter or bylaws (or comparable organizational documents) of Mercantile and its subsidiaries, and any existing indemnification agreements, shall survive the merger and shall continue in full force and effect in accordance with their terms, and shall not be amended, repealed or otherwise modified after the effective time of the merger, except for those set forth in the organizational documents of Mercantile or its subsidiaries, which shall not be amended, repealed or otherwise modified for a period of six years after the effective time of the merger.

The merger agreement provides that PNC will, for a period of six years after the effective time of the merger, maintain directors and officers liability insurance for the individuals serving as directors and officers of Mercantile immediately prior to the effective time of the merger with respect to acts or omissions occurring prior to the effective time of the merger that were committed by such directors and officers in such capacities. The merger agreement provides that such directors and officers liability insurance will be comparable to that currently maintained by Mercantile for such individuals; provided that PNC is not required to expend an annual aggregate amount in excess of 250% of the annual premiums currently paid by Mercantile for such insurance.

Board of Directors of PNC

The merger agreement provides that PNC shall appoint two individuals mutually agreed by Mercantile and PNC to the Board of Directors of PNC as of the effective time of the merger, and that PNC shall increase the size of the PNC Board of Directors if required to permit the appointment of these individuals as directors. It is currently expected that [ ] and [ ] will be elected to the PNC Board of Directors.

THE MERGER AGREEMENT

The following describes certain aspects of the merger, including material provisions of the merger agreement. The following description of the merger agreement is subject to, and qualified in its entirety by reference to, the merger agreement, which is attached to this document as Annex A and is incorporated by reference in this document. We urge you to read the merger agreement carefully and in its entirety, as it is the legal document governing this merger.

Terms of the Merger

Each of the Mercantile board of directors and the PNC board of directors has approved the merger agreement which provides for the merger of Mercantile with and into PNC. PNC will be the surviving corporation in the merger. Each share of PNC common or preferred stock issued and outstanding immediately prior to completion of the merger will remain issued and outstanding as one share of common or preferred stock of PNC, as applicable, and each share of Mercantile common stock issued and outstanding immediately prior to the completion of the merger, except for specified shares of Mercantile common stock held by Mercantile and PNC, will be converted into the right to receive 0.4184 of a share of PNC common stock and $16.45 in cash, without interest. If the number of shares of common stock of PNC changes before the merger is completed because of a reorganization, recapitalization, reclassification, stock dividend, stock split, reverse stock split, or other similar event, then an appropriate and proportionate adjustment will be made to the number of shares of PNC common stock into which each share of Mercantile common stock will be converted.

PNC will not issue any fractional shares of PNC common stock in the merger. Instead, a Mercantile stockholder who otherwise would have received a fraction of a share of PNC common stock will receive an amount in cash rounded to the nearest cent, determined by multiplying the fraction of a share of PNC common stock to which the holder would otherwise be entitled by the average closing price of PNC common stock over the five trading days immediately prior to the date on which the merger is completed.

The PNC articles of incorporation will be the articles of incorporation, and the PNC bylaws will be the bylaws, of the combined company after completion of the merger. The merger agreement provides that PNC may change the structure of the merger if consented to by Mercantile (but Mercantile s consent cannot be unreasonably withheld or delayed). No such change will alter the amount or kind of merger consideration to be provided under the merger agreement, adversely affect the tax consequences to Mercantile stockholders in the merger or materially impede or delay completion of the merger.

Treatment of Mercantile Stock Options and Other Equity-Based Awards

Each outstanding option to purchase shares of Mercantile common stock granted under any stock compensation plan maintained by Mercantile or its subsidiaries, which we refer to as the Mercantile stock plans, to employees or directors of Mercantile or its subsidiaries, whether vested or not, will be cancelled in exchange for the right to receive a lump sum cash payment to be paid as soon as practicable after the completion of the merger. The lump sum cash payment shall equal the product of (i) the number of shares of Mercantile common stock subject to the outstanding portion of the option and (ii) the excess, of the all cash consideration over the exercise price per share of the option. The all cash consideration will equal the sum of (a) $16.45 and (b) the product of 0.4184 multiplied by the average, rounded to the nearest one-ten thousandth, of the closing sales prices of PNC common stock for the five trading days immediately preceding the date of completion of the merger. The lump sum cash payment shall be subject to applicable tax withholding.

Each outstanding restricted share of Mercantile common stock and each outstanding restricted stock unit of Mercantile common stock granted under the Mercantile stock plans, regardless of whether or not vested, shall be cancelled and converted into the right to receive, without restrictions, the merger consideration, which is (a) 0.4184 of a share of PNC common stock and (b) cash equal to $16.45. PNC shall be entitled to deduct applicable tax withholding.

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Each phantom stock unit with respect to Mercantile common stock granted under certain non-employee director deferred compensation plans shall cease to represent rights with respect to Mercantile common stock and shall be converted into, at the option of Mercantile, the all cash consideration or the merger consideration or phantom stock units with respect to an equivalent number of shares of PNC common stock. If the latter option is selected, the number of phantom stock units with respect to PNC common stock would equal the number of shares of Mercantile common stock subject to such phantom stock units multiplied by the sum of (a) $16.45 divided by the average, rounded to the nearest one-ten thousandth, of the closing sales prices of PNC common stock for the five trading days immediately preceding the date of the completion of the merger and (b) 0.4184.

Closing and Effective Time of the Merger

The merger will be completed only if all of the following occur:

- the merger is approved by Mercantile stockholders;
- we obtain all required governmental and regulatory consents and approvals without a condition or restriction that would have a material adverse effect on PNC, measured on a scale relative to Mercantile; and
- all other conditions to the merger discussed in this document and the merger agreement are either satisfied or waived.

The merger will become effective when articles of merger are filed with the Maryland State Department of Assessments and Taxation and the Department of State of the Commonwealth of Pennsylvania. However, we may agree to a later time for completion of the merger and specify that time in accordance with Maryland and Pennsylvania law. In the merger agreement, we have agreed to cause the completion of the merger to occur no later than the fifth business day following the satisfaction or waiver of the last of the conditions specified in the merger agreement, or on another mutually agreed date. If these conditions are first satisfied or waived during the two weeks immediately prior to the end of a fiscal quarter of PNC, then PNC may postpone the closing until the first full week after the end of that quarter. It currently is anticipated that the effective time of the merger will occur in the first quarter of 2007, but we cannot guarantee when or if the merger will be completed.

Board of Directors of the Surviving Corporation

Before completion of the merger, PNC will take such actions as may be reasonably required to appoint two additional directors to PNC s board, with the directors to be mutually agreed on by PNC and Mercantile.

Charitable Donation

If the merger is consummated, PNC has agreed that either it or the PNC Foundation will make a charitable donation of $25 million to Mercantile s charitable foundation for charitable causes in the Baltimore area.

Conversion of Shares; Exchange of Certificates

The conversion of Mercantile common stock into the right to receive the merger consideration will occur automatically at the effective time of the merger. As soon as reasonably practicable after completion of the merger, the exchange agent will provide to Mercantile stockholders of record the letter of transmittal described below and, as soon as reasonably practicable after the completed letter and Mercantile stock certificates are returned to the exchange agent, will exchange certificates representing shares of Mercantile common stock for merger consideration to be received pursuant to the terms of the merger agreement. Prior to the completion of the merger, PNC will select a bank or trust company reasonably acceptable to Mercantile, or PNC s transfer agent, to be the exchange agent, who will exchange certificates for the merger consideration and perform other duties as explained in the merger agreement.

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Letter of Transmittal

Soon after the completion of the merger, the exchange agent will mail a letter of transmittal to each holder of a Mercantile common stock certificate at the effective time of the merger. This mailing will contain instructions on how to surrender Mercantile common stock certificates in exchange for statements indicating book-entry ownership of PNC common stock and a check in the appropriate amount of the cash portion of the merger consideration. If a holder of a Mercantile common stock certificate makes a special request, however, PNC will issue to the requesting holder a PNC stock certificate in lieu of book-entry shares. When you deliver your Mercantile stock certificates to the exchange agent along with a properly executed letter of transmittal and any other required documents, your Mercantile stock certificates will be cancelled and you will receive statements indicating book-entry ownership of PNC common stock, or, if requested, stock certificates representing the number of full shares of PNC common stock to which you are entitled under the merger agreement. You will receive payment in cash, without interest, for the cash portion of the merger consideration and an additional cash payment instead of any fractional shares of PNC common stock that would have been otherwise issuable to you as a result of the merger.

Holders of Mercantile common stock should not submit their Mercantile stock certificates for exchange until they receive the transmittal instructions and a form of letter of transmittal from the exchange agent.

If a certificate for Mercantile common stock has been lost, stolen or destroyed, the exchange agent will issue the consideration properly payable under the merger agreement upon receipt of an affidavit of that fact from the claimant, and, if reasonably required by the exchange agent or PNC, the posting of a bond by the claimant.

After completion of the merger, there will be no further transfers on the stock transfer books of Mercantile, except as required to settle trades executed prior to completion of the merger.

Withholding

The exchange agent will be entitled to deduct and withhold from the cash consideration or cash in lieu of fractional shares payable to any Mercantile stockholder the amounts the exchange agent is required to deduct and withhold under any federal, state, local or foreign tax law. If the exchange agent withholds any amounts, these amounts will be treated for all purposes of the merger as having been paid to the stockholders from whom they were withheld.

Dividends and Distributions

Until Mercantile common stock certificates are surrendered for exchange, any dividends or other distributions declared after the effective time with respect to PNC common stock into which shares of Mercantile common stock may have been converted will accrue but will not be paid. PNC will pay to former Mercantile stockholders any unpaid dividends or other distributions, without interest, only after they have duly surrendered their Mercantile stock certificates.

Prior to the effective time of the merger, Mercantile and its subsidiaries may not declare or pay any dividend or distribution on its capital stock or repurchase any shares of its capital stock, other than:

- regular quarterly cash dividends at a rate not to exceed $0.28 per share of Mercantile common stock with record dates and payment dates consistent with the prior year;

- dividends paid by any subsidiary of Mercantile to Mercantile or to any of its wholly-owned subsidiaries;

- the acceptance of shares of Mercantile common stock in payment of the exercise of a stock option or the vesting of restricted shares of Mercantile common stock granted under a Mercantile stock plan, in each case in accordance with past practice; and dividends on the capital securities and common securities issued under the three James Monroe Statutory Trusts, in each case in accordance with the terms thereof.

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Mercantile and PNC have agreed to coordinate declaration of dividends so that holders of Mercantile common stock will not receive two dividends, or fail to receive one dividend, for any quarter with respect to their Mercantile common stock and any PNC common stock any holder receives in the merger.

Representations and Warranties

The merger agreement contains customary representations and warranties of Mercantile and PNC relating to their respective businesses. With the exception of certain representations that must be true and correct in all material respects (or, in the case of specific representations and warranties regarding the capitalization of Mercantile, true and correct except to a *de minimis* extent), no representation or warranty will be deemed untrue or incorrect as a consequence of the existence or absence of any fact, circumstance or event unless that fact, circumstance or event, individually or when taken together with all other facts, circumstances or events, has had or is reasonably likely to have a material adverse effect on the ability of the company making the representation to consummate the merger, or on the business, results of operations or financial conditions of the company (including any impact on its customers and employees) making the representation. In determining whether a material adverse effect has occurred or is reasonably likely, the parties will disregard effects resulting from (1) changes in generally accepted accounting principles or regulatory accounting requirements applicable to banks or savings associations and their holding companies generally, (2) changes in laws, rules or regulations of general applicability to banks or savings associations and their holding companies, generally, or their interpretations by courts or governmental entities, (3) changes in global or national or regional political conditions or in general or regional economic or market conditions affecting banks, savings associations or their holding companies generally, except to the extent that such changes in general or market conditions have a materially disproportionate adverse effect on such party, or (4) public disclosure of the merger. The representations and warranties in the merger agreement do not survive the effective time of the merger.

Each of PNC and Mercantile has made representations and warranties to the other regarding, among other things:

- corporate matters, including due organization and qualification;
- capitalization;
- authority relative to execution and delivery of the merger agreement and the absence of conflicts with, or violations of, organizational documents or other obligations as a result of the merger;
- required governmental filings and consents;
- the timely filing of reports with governmental entities, and the absence of investigations by regulatory agencies;
- financial statements, internal controls and accounting;
- broker s fees payable in connection with the merger;
- the absence of material adverse changes;
- legal proceedings;

tax matters;

compliance with applicable laws;

risk management instruments and derivatives;

investment and loan portfolios;

real property;

environmental liabilities;

tax treatment of the merger; and

the accuracy of information supplied for inclusion in this document and other similar documents.

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In addition, Mercantile has made other representations and warranties about itself to PNC as to:

- employee matters, including employee benefit plans;
- material contracts, exclusivity arrangements, and other certain types of contracts;
- intellectual property;
- broker-dealer subsidiaries;
- the inapplicability of state takeover laws and the rights agreement; and
- the receipt of a financial advisor s opinion.

PNC also has made a representation and warranty to Mercantile regarding the availability of cash to pay the cash portion of the merger consideration.

The representations and warranties described above and included in the merger agreement were made by each of PNC and Mercantile to the other. These representations and warranties were made as of specific dates, may be subject to important qualifications and limitations agreed to by PNC and Mercantile in connection with negotiating the terms of the merger agreement, and may have been included in the merger agreement for the purpose of allocating risk between PNC and Mercantile rather than to establish matters as facts. The merger agreement is described in, and included as an annex to, this document only to provide you with information regarding its terms and conditions, and not to provide any other factual information regarding Mercantile, PNC or their respective businesses. Accordingly, the representations and warranties and other provisions of the merger agreement should not be read alone, but instead should be read only in conjunction with the information provided elsewhere in this document and in the documents incorporated by reference into this document. See Where You Can Find More Information on page [ ].

Covenants and Agreements

Each of Mercantile and PNC has undertaken customary covenants that place restrictions on it and its subsidiaries until the effective time of the merger. In general, each of PNC and Mercantile agreed to (1) conduct its business in the ordinary course in all material respects, (2) use commercially reasonable efforts to maintain and preserve intact its business organization and advantageous business relationships, including retaining the services of key officers and employees, and (3) take no action that is intended to or would reasonably be expected to adversely affect or materially delay its respective ability to obtain any necessary regulatory approvals, perform its covenants or complete the merger. Mercantile further agrees that, with certain exceptions and except with PNC s prior written consent, Mercantile will not, and will not permit any of its subsidiaries to, among other things, undertake the following extraordinary actions:

- incur indebtedness or in any way assume the indebtedness of another person, except in the ordinary course of business;
- adjust, split, combine or reclassify any of its capital stock;
- make, declare or pay any dividends or other distributions on any shares of its capital stock, except as set forth above in Conversion of Shares; Exchange of Certificates Dividends and Distributions ;

issue shares, stock options or other equity-based awards outside the parameters set forth in the merger agreement;

except as contemplated by the merger agreement and except in certain circumstances as in the ordinary course of business, (1) increase wages, salaries or incentive compensation, (2) pay or provide, or increase or accelerate the accrual rate, vesting or timing or payment or funding of, any compensation or benefit to employees of Mercantile and its subsidiaries or otherwise pay any amount to which any employee of Mercantile or any of its subsidiaries is not entitled, or (3) establish, adopt or become a party to any new employee benefit or compensation plan or agreement or amend, suspend or terminate any Mercantile benefit plan;

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other than in the ordinary course of business, sell, transfer, mortgage, encumber or otherwise dispose of any material assets or properties, or cancel, release or assign any material indebtedness;

enter into any new line of business or change in any material respect its lending, investment, underwriting, risk and asset liability management and other banking, operating, and servicing policies other than as required by applicable law;

make any material investment for its own account either by purchase of securities, capital contributions, property transfers or purchase of property or assets;

take any action or knowingly fail to take any action reasonably likely to prevent the merger from qualifying as a reorganization for United States federal income tax purposes;

amend its charter or bylaws;

restructure or materially change its investment securities portfolio or its gap position;

commence or settle any material claim except settlements involving only monetary remedies in the ordinary course of business consistent with past practice not in excess of $500,000 individually or $2,000,000 in the aggregate;

take any action that is intended, or may be reasonably expected, to cause any of the conditions to the merger to fail to be satisfied;

make any material change to its financial accounting methods, except as required by applicable law or generally accepted or regulatory accounting principles;

enter into, renew or terminate, or make any payment not then required under employment contracts, material contracts, exclusivity arrangements, collective bargaining agreement, or other certain types of contracts other than, subject to certain exceptions, in the ordinary course of business consistent with past practice;

make, change, or revoke any material tax election, change an annual tax accounting period, adopt or change any tax accounting method, file any material amended tax return, enter into any closing agreement with respect to a material amount of taxes, settle any material tax claim or assessment or surrender any right to claim a refund of a material amount of taxes;

file any application to establish, or to relocate or terminate the operations of, any banking office of Mercantile or any Mercantile subsidiary; or

agree to take or adopt any resolutions by the board of directors in support of any of the actions prohibited by the preceding bullets.

PNC agrees that, except with Mercantile s prior written consent, PNC will not, among other things, undertake the following extraordinary actions:

amend any charter documents in a manner that would adversely affect Mercantile or its stockholders or the merger;

take any action or knowingly fail to take any action reasonably likely to prevent the merger from qualifying as a reorganization for United States federal income tax purposes;

take any action that is intended, or may be reasonably expected, to result in any of the conditions to the merger not being satisfied;

take any action that would reasonably be expected to prevent, materially impede or materially delay completion of the merger;

make or pay any extraordinary one-time dividend or distribution on shares of PNC common stock (other than any dividend or distribution of PNC common stock); or

agree to take or adopt any resolutions by the board of directors in support of any of the actions prohibited by the preceding bullets.

The merger agreement also contains mutual covenants relating to the preparation of this document and the holding of the special meeting of Mercantile stockholders, access to information of the other company and public announcements with respect to the transactions contemplated by the merger agreement. Mercantile and PNC have also agreed to use their reasonable best efforts to take all actions needed to obtain necessary governmental and third party consents. Notwithstanding the foregoing, PNC is not required to take any action in connection with obtaining the necessary governmental and third party consents that would reasonably be expected to have a material adverse effect, measured relative to Mercantile.

Reasonable Best Efforts of Mercantile to Obtain the Required Stockholder Vote

Mercantile has agreed to hold a meeting of its stockholders as soon as is reasonably practicable for the purpose of obtaining stockholder approval of the merger. Mercantile will use its reasonable best efforts to obtain such approval. Mercantile s board of directors may withdraw, modify, condition or refuse to recommend the adoption of the merger agreement if Mercantile s board of directors determines, in good faith after consultation with its outside financial and legal advisors, that the failure to take such action would be inconsistent with its fiduciary obligations under applicable law. Notwithstanding the forgoing, the merger agreement requires Mercantile to submit the merger agreement to a stockholder vote even if its board of directors no longer recommends approval of the merger agreement, in which event the board may communicate its basis for its lack of a recommendation to stockholders.

Agreement Not to Solicit Other Offers

Mercantile also has agreed that it, its subsidiaries and their officers, directors, or employees will not, directly or indirectly:

- initiate, solicit, encourage or facilitate any inquiries or proposals for any Alternative Proposal (as defined below); or

- participate in any discussions or negotiations, or enter into any agreement, regarding any Alternative Transaction (as defined below).

However, prior to the special meeting, Mercantile may consider and participate in discussions and negotiations with respect to a *bona fide* Alternative Proposal if (1) it has first entered into a confidentiality agreement with the party proposing the Alternative Proposal on terms comparable to the confidentiality agreement with PNC and (2) the Mercantile board of directors determines reasonably in good faith (after consultation with outside legal counsel) that failure to take these actions would be inconsistent with its fiduciary duties.

Mercantile has agreed:

- to notify PNC promptly (but in no event later than 24 hours) after it receives any Alternative Proposal, or any material change to any Alternative Proposal, or any request for nonpublic information relating to Mercantile or any of its subsidiaries, and to provide PNC with relevant information regarding the Alternative Proposal or request;

- to keep PNC fully informed, on a current basis, of any material changes in the status and any material changes in the terms of any such Alternative Proposal; and

- to cease any existing discussions or negotiations with any persons with respect to any Alternative Proposal, and to use reasonable best efforts to cause all persons other than PNC who have been furnished with confidential information in connection with an Alternative Proposal within the 12 months prior to the date of the merger agreement to return or destroy such information.

As used in the merger agreement, an Alternative Proposal means any inquiry or proposal regarding any merger, share exchange, consolidation, sale of assets, sale of shares of capital stock (including by way of a tender offer) or similar transactions involving Mercantile or any of its subsidiaries that, if completed, would constitute an Alternative Transaction.

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As used in the merger agreement, Alternative Transaction means any of the following:

- a transaction pursuant to which any person (or group of persons) other than PNC or its affiliates, directly or indirectly, acquires or would acquire more than 25% of the outstanding shares of Mercantile common stock or outstanding voting power or of any new series or new class of Mercantile preferred stock that would be entitled to a class or series vote with respect to the merger, whether from Mercantile or pursuant to a tender offer or exchange offer or otherwise;

- a merger, share exchange, consolidation or other business combination involving Mercantile (other than the merger being described here);

- any transaction pursuant to which any person (or group of persons) other than PNC or its affiliates acquires or would acquire control of assets (including, for this purpose, the outstanding equity securities of subsidiaries of Mercantile and securities of the entity surviving any merger or business combination including any of Mercantile s subsidiaries) of Mercantile, or any of its subsidiaries representing more than 25% of the fair market value of all the assets, net revenues or net income of Mercantile and its subsidiaries, taken as a whole, immediately prior to such transaction; or

- any other consolidation, business combination, recapitalization or similar transaction involving Mercantile or any of its subsidiaries, other than the transactions contemplated by the merger agreement, as a result of which the holders of shares of Mercantile common stock immediately prior to the transaction do not, in the aggregate, own at least 75% of each of the outstanding shares of common stock and the outstanding voting power of the surviving or resulting entity in the transaction immediately after the completion of the transaction in substantially the same proportion as the holders held the shares of Mercantile common stock immediately prior to the completion of the transaction.

Expenses and Fees

In general, each of PNC and Mercantile will be responsible for all expenses incurred by it in connection with the negotiation and completion of the transactions contemplated by the merger agreement. However, the costs and expenses of printing and mailing this document, and all filing and other fees paid to the SEC in connection with the merger, shall be borne equally by Mercantile and PNC.

Employee Matters

PNC has agreed, with respect to the employees of Mercantile and its subsidiaries at the effective time, it will or will cause its applicable subsidiaries to provide such employees in the aggregate with employee benefits, rates of base salary or hourly wage and annual bonus opportunities that are (1) substantially similar in the aggregate to the aggregate employee benefits, rates of base salary or hourly wage and annual bonus opportunities provided to such employees pursuant to Mercantile s benefit plans as in effect immediately prior to the merger or (2) no less favorable than those provided to similarly situated PNC employees, and provide severance protection for such employees who are terminated without cause during the one-year period following the merger.

In addition, PNC has agreed, to the extent any Mercantile employee becomes eligible to participate in PNC benefit plans following the merger:

- generally to recognize each employee s service with Mercantile prior to the completion of the merger for purposes of eligibility to participate, vesting credits and, except under defined benefit pension plans, other than for certain purposes, benefit accruals, in each case under the PNC plans to the same extent such service was recognized under comparable Mercantile plans prior to completion of the merger; and

- to waive any exclusion for pre-existing conditions under any PNC health, dental or vision plans, to the extent such limitation would have been waived or satisfied under a corresponding Mercantile plan in which such employee participated immediately prior to the effective time, and recognize any medical or health expenses incurred in the year in which the merger closes for purposes of applicable deductible and annual out-of-pocket expense requirements under any health, dental or vision plan of PNC.

However, PNC has no obligation to continue the employment of any Mercantile employee for any period following the merger.

Indemnification and Insurance

The merger agreement requires PNC to maintain in effect for six years after completion of the merger the current rights of Mercantile directors, officers and employees to indemnification under the Mercantile articles of incorporation or the Mercantile bylaws or disclosed agreements of Mercantile. The merger agreement also provides that, upon completion of the merger, PNC will indemnify and hold harmless, and provide advancement of expenses to, all past and present officers, directors and employees of Mercantile and its subsidiaries in their capacities as such against all losses, claims, damages, costs, expenses, liabilities, judgments or amounts paid in settlement to the fullest extent permitted by applicable laws.

The merger agreement provides that PNC will maintain for a period of six years after completion of the merger Mercantile s current directors and officers liability insurance policies, or policies of at least the same coverage and amount and containing terms and conditions that are not less advantageous than the current policy, with respect to acts or omissions occurring prior to the effective time of the merger, except that PNC is not required to incur annual premium expense greater than 250% of Mercantile s current annual directors and officers liability insurance premium.

Conditions to Complete the Merger

Our respective obligations to complete the merger are subject to the fulfillment or waiver of certain conditions, including:

- the approval of the merger by Mercantile stockholders;
- the approval of the listing of PNC common stock to be issued in the merger on the NYSE, subject to official notice of issuance;
- the effectiveness of the registration statement of which this document is a part with respect to the PNC common stock to be issued in the merger under the Securities Act and the absence of any stop order or proceedings initiated or threatened by the SEC for that purpose; and
- the absence of any law, statute, regulation, judgment, decree, injunction or other order in effect by any court or other governmental entity that prohibits completion of the transactions contemplated by the merger agreement.

Each of PNC s and Mercantile s obligations to complete the merger is also separately subject to the satisfaction or waiver of a number of conditions including:

- the receipt by each of PNC and Mercantile of a legal opinion with respect to certain United States federal income tax consequences of the merger;
- the receipt and effectiveness of all governmental and other approvals, registrations and consents, and the expiration of all related waiting periods required to complete the merger (in the case of the conditions to PNC s obligation to complete the merger, without any conditions or restrictions that would have a material adverse effect on PNC, measured on a scale relative to Mercantile); and
- the truth and correctness of the representations and warranties of each other party in the merger agreement, subject to the materiality standard provided in the merger agreement, and the performance by each other party in all material respects of their obligations under the merger agreement and the receipt by each party of certificates from the other party to that effect.

We cannot provide assurance as to when or if all of the conditions to the merger can or will be satisfied or waived by the appropriate party. As of the date of this document, we have no reason to believe that any of these conditions will not be satisfied.

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Termination of the Merger Agreement

The merger agreement can be terminated at any time prior to completion by mutual consent, if authorized by each of our boards of directors, or by either party in the following circumstances:

- if any of the required regulatory approvals are denied (and the denial is final and nonappealable);
- if the merger has not been completed by October 8, 2007, unless the failure to complete the merger by that date is due to the terminating party s failure to abide by the merger agreement;
- if there is a breach by the other party that would cause the failure of the closing conditions described above, unless the breach is capable of being, and is, cured within 45 days of notice of the breach; or
- if the stockholders of Mercantile fail to approve the merger at the special meeting.

In addition, PNC may terminate the merger agreement if the Mercantile board of directors fails to recommend that Mercantile stockholders approve the merger, withdraws, modifies or qualifies in a manner adverse to PNC its recommendation of the merger to stockholders, or recommends a competing merger proposal in a manner adverse to PNC. PNC may also terminate the merger agreement if Mercantile intentionally breaches its obligation to call and hold a stockholder meeting to consider the merger or its obligation to not solicit competing acquisition proposals.

Effect of Termination. If the merger agreement is terminated, it will become void, and there will be no liability on the part of PNC or Mercantile, except that (1) both PNC and Mercantile will remain liable for any willful breach of the merger agreement and (2) designated provisions of the merger agreement, including the payment of fees and expenses, the confidential treatment of information and publicity restrictions, will survive the termination.

Termination Fee

Mercantile must pay PNC a termination fee of $225 million if:

- the merger agreement is terminated by PNC as a result of the PNC termination rights described under Termination of the Merger Agreement above relating to the Mercantile stockholder recommendation and compliance with the stockholder vote and non-solicit covenants; or
- (1) a competing takeover proposal is made to Mercantile or its stockholders or has been publicly announced, (2) the merger agreement is terminated by Mercantile or PNC because the merger has not been completed within one year of signing or because the stockholders of Mercantile do not approve the merger at the stockholder meeting and (3) either Mercantile completes an alternative transaction within 12 months of termination or Mercantile enters into a definitive agreement relating to a competing takeover proposal within 12 months of termination (in which case Mercantile will pay one-third of the termination fee on that date) and the transaction is completed within 18 months of termination (in which case Mercantile will pay the remaining two-thirds of the termination fee).

Amendment, Waiver and Extension of the Merger Agreement

Subject to applicable law, the parties may amend the merger agreement by action taken or authorized by their boards of directors or by written agreement. However, after any approval of the transactions contemplated by the merger agreement by the Mercantile stockholders, there may not be, without further approval of those stockholders, any amendment of the merger agreement that (1) changes the amount or the form of the consideration to be delivered to the holders of Mercantile common stock, (2) changes any term of the articles of incorporation of the combined company or (3) changes any of the terms and conditions of the merger agreement if such change would adversely affect the holders of any Mercantile securities, in each case other than as contemplated by the merger agreement.

At any time prior to the completion of the merger, each of us, by action taken or authorized by our respective board of directors, to the extent legally allowed, may:

- extend the time for the performance of any of the obligations or other acts of the other party;
- waive any inaccuracies in the representations and warranties of the other party; or
- waive compliance by the other party with any of the other agreements or conditions contained in the merger agreement.

Resales of PNC Stock by Affiliates

Shares of PNC common stock to be issued to Mercantile stockholders in the merger have been registered under the Securities Act, and may be traded freely and without restriction by those stockholders not deemed to be affiliates (as that term is defined under the Securities Act) of Mercantile. Any subsequent transfers of shares, however, by any person who is an affiliate of Mercantile at the time the merger is submitted for a vote of the Mercantile stockholders will, under existing law, require:

- the further registration under the Securities Act of the PNC stock to be transferred;
- compliance with Rule 145 promulgated under the Securities Act, which permits limited sales under certain circumstances; or
- the availability of another exemption from registration.

An affiliate of Mercantile is a person who directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, Mercantile. These restrictions are expected to apply to the directors and executive officers of Mercantile and the holders of 10% or more of the outstanding Mercantile common stock. The same restrictions apply to the spouses and certain relatives of those persons and any trusts, estates, corporations or other entities in which those persons have a 10% or greater beneficial or equity interest.

PNC will give stop transfer instructions to the exchange agent with respect to the shares of PNC common stock to be received by persons subject to these restrictions, and the certificates for their shares will be appropriately legended. PNC is not required to further register the sale of PNC common stock to be issued to affiliates of Mercantile.

Mercantile has agreed in the merger agreement to use its reasonable best efforts to cause each person who is an affiliate of Mercantile for purposes of Rule 145 under the Securities Act to deliver to PNC a written agreement intended to ensure compliance with the Securities Act.

ACCOUNTING TREATMENT

The merger will be accounted for as a purchase, as that term is used under generally accepted accounting principles, for accounting and financial reporting purposes. Under purchase accounting, the assets (including identifiable intangible assets) and liabilities (including executory contracts and other commitments) of Mercantile as of the effective time of the merger will be recorded at their respective fair values and added to those of PNC. Any excess of purchase price over the fair values is recorded as goodwill. Financial statements of PNC issued after the merger would reflect these fair values and would not be restated retroactively to reflect the historical financial position or results of operations of Mercantile.

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MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF THE MERGER

The following is a general discussion of the anticipated material United States federal income tax consequences to U.S. holders (as defined below) of Mercantile common stock of the receipt of shares of PNC common stock and cash in exchange for Mercantile common stock pursuant to the merger. This summary is based upon the provisions of the Code, applicable current and proposed United States Treasury Regulations, judicial authorities and administrative rulings and practice, all as in effect as of the date of this registration statement and all of which are subject to change, possibly on a retroactive basis.

For purposes of this discussion, the term U.S. holder means a beneficial owner of Mercantile common stock that is for United States federal income tax purposes: (i) a citizen or resident of the United States; (ii) a corporation, or other entity taxable as a corporation for United States federal income tax purposes, created or organized in or under the laws of the United States or any state thereof or the District of Columbia; (iii) a trust if it (a) is subject to the primary supervision of a court within the United States and one or more United States persons have the authority to control all substantial decisions of the trust or (b) has a valid election in effect under applicable United States Treasury Regulations to be treated as a United States person; or (iv) an estate the income of which is subject to United States federal income tax regardless of its source.

Holders of Mercantile common stock who are not U.S. holders may have different tax consequences than those described below and are urged to consult their own tax advisors regarding the tax treatment to them under United States and non-United States tax laws.

The United States federal income tax consequence to a partner in an entity treated as a partnership, for United States federal income tax purposes, that holds Mercantile common stock generally will depend on the status of the partner and the activities of the partnership. Partners in a partnership holding Mercantile common stock should consult their own tax advisors.

This discussion assumes that a U.S. holder holds Mercantile common stock as a capital asset within the meaning of Section 1221 of the Code. This discussion does not address all aspects of United States federal income taxation that may be relevant to a U.S. holder in light of its personal circumstances or to U.S. holders subject to special treatment under the United States federal income tax laws (for example, insurance companies, dealers or brokers in securities or currencies, traders in securities who elect mark-to-market accounting, tax-exempt organizations, financial institutions, mutual funds, partnerships or other pass-through entities (and persons holding Mercantile common stock through a partnership or other pass-through entity), United States expatriates and stockholders subject to alternative minimum tax, U.S. holders who hold Mercantile common stock as part of a hedging, straddle, conversion or other integrated transaction, a person whose functional currency for United States federal income tax purposes in not the U.S. dollar or U.S. holders who acquired their Mercantile common stock through the exercise of employee stock options or other compensation arrangements). In addition, the discussion does not address any aspect of foreign, state, local, estate or gift taxation that may be applicable to a U.S. holder.

Holders of Mercantile common stock are strongly urged to consult with their own tax advisors as to the tax consequences of the merger on their particular circumstances, including the applicability and effect of the alternative minimum tax and any state, local or foreign and other tax laws and of changes in those laws.

Tax Consequences of the Merger Generally

PNC and Mercantile have structured the merger to qualify as a reorganization within the meaning of Section 368(a) of the Code. It is a condition to PNC s obligation to complete the merger that PNC receive an opinion of its counsel, Wachtell, Lipton, Rosen & Katz, dated the closing date of the merger, substantially to the effect that the merger will be treated as a reorganization within the meaning of Section 368(a) of the Code. It is a condition to Mercantile s obligation to complete the merger that Mercantile receive an opinion of its counsel, Davis Polk & Wardwell, dated the closing date of the merger, substantially to the effect that the merger will be treated as a reorganization within the meaning of Section 368(a) of the Code. These opinions will be based on facts, representations and assumptions set forth in the opinion and representations set forth in certificates to be received from PNC and Mercantile. None of the tax opinions given in connection with the merger or the opinions described below will be binding on the Internal Revenue Service, and neither PNC nor Mercantile intends to request any ruling from the Internal Revenue Service as to the United States federal income tax consequences of the merger.

Consequently, no assurance can be given that the Internal Revenue Service will not assert, or that a court would not sustain, a position contrary to any of those set forth below. In addition, if any of the facts, representations or assumptions upon which those opinions are based is inconsistent with the actual facts, the United States federal income tax consequences of the merger could be adversely affected. It is assumed for purposes of the remainder of the discussion that the merger will qualify as a reorganization within the meaning of the Code. Based on this assumption, upon the exchange of Mercantile common stock for a combination of PNC common stock and cash, a U.S. holder will generally recognize gain (but not loss) in an amount equal to the lesser of:

- the amount of gain realized (i.e., the excess, if any, of the sum of the cash and the fair market value of the PNC common stock a U.S. holder received over its tax basis in the Mercantile common stock surrendered in the merger); and

- the amount of cash received in the merger (other than cash received instead of a fractional share of PNC common stock).

For this purpose, gain or loss must be calculated separately for each identifiable block of shares surrendered in the exchange, and a loss realized on one block of shares may not be used to offset a gain realized on another block of shares. If a U.S. holder has different bases or holding periods in respect of shares of Mercantile common stock, a U.S. holder should consult its tax advisor prior to the exchange with regard to identifying the bases or holding periods of the particular shares of PNC common stock received in the merger.

Any recognized gain will generally be long-term capital gain if the U.S. holder s holding period with respect to the Mercantile common stock surrendered is more than one year at the effective time of the merger. In some cases, where a U.S. holder actually or constructively owned PNC common stock immediately before the merger, such cash received in the merger could be treated as having the effect of the distribution of a dividend, under the tests set forth in Section 302 of the Code, in which case such gain would be treated as ordinary dividend income. These rules are complex and dependent upon the specific factual circumstances particular to each U.S. holder. Consequently, each U.S. holder that may be subject to those rules should consult its tax advisor as to the application of these rules to the particular facts relevant to such U.S. holder.

Tax Basis and Holding Period

A U.S. holder s aggregate tax basis in the shares of PNC common stock received in the merger, including any fractional share interests deemed received by the U.S. holder under the treatment described below, will equal its aggregate adjusted tax basis in the Mercantile common stock surrendered in the merger, increased by the amount of taxable gain, if any, recognized in the merger (including any portion of the gain that is treated as a dividend but excluding any gain or loss resulting from the deemed receipt and redemption of a fractional share interest described below) and decreased by the amount of any cash received in the merger (excluding any cash received instead of a fractional share interest). The holding period for the shares of PNC common stock received in the merger (including a fractional share interest deemed received and redeemed as described below) will include the holding period for the shares of Mercantile common stock surrendered in the merger.

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Cash Instead of a Fractional Share

A U.S. holder who receives cash instead of a fractional share of PNC common stock will be treated as having received the fractional share of PNC common stock pursuant to the merger and then as having exchanged the fractional share of PNC common stock for cash in a redemption by PNC. In general, this deemed redemption will be treated as a sale or exchange, provided the redemption is not essentially equivalent to a dividend. The determination of whether a redemption is essentially equivalent to a dividend depends upon whether and to what extent the redemption reduces the U.S. holder s deemed percentage stock ownership of PNC. While this determination is based on each U.S. holder s particular facts and circumstances, the Internal Revenue Service has ruled that a redemption is not essentially equivalent to a dividend and will therefore result in sale or exchange treatment in the case of a shareholder of a publicly held company whose relative stock interest is minimal and who exercises no control over corporate affairs if the redemption results in even a minor reduction in the stock interest of the shareholder. As a result, the redemption of a fractional share of PNC common stock is generally treated as a sale or exchange and not as a dividend, and a U.S. holder generally will recognize capital gain or loss equal to the difference between the amount of cash received and the basis in its fractional share of PNC common stock as set forth above. This capital gain or loss generally will be long-term capital gain or loss if, as of the effective date of the merger, the holding period for the shares is greater than one year. The deductibility of capital losses is subject to limitations.

Information Reporting and Backup Withholding

Cash payments received in the merger by a U.S. holder may, under certain circumstances, be subject to information reporting and backup withholding (currently at a rate of 28%) of the cash payable to the holder, unless the holder provides proof of an applicable exemption or furnishes its taxpayer identification number, and otherwise complies with all applicable requirements of the backup withholding rules. Any amounts withheld from payments to a U.S. holder under the backup withholding rules are not additional tax and will be allowed as a refund or credit against the U.S. holder s United States federal income tax liability, provided that the required information is timely furnished to the Internal Revenue Service.

Reporting Requirements

A U.S. holder who receives shares of PNC common stock as a result of the merger will be required to retain records pertaining to the merger and will be required to file with its United States federal income tax return for the year in which the merger takes place a statement setting forth certain facts relating to the merger.

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INFORMATION ABOUT THE COMPANIES

The PNC Financial Services Group, Inc.

The PNC Financial Services Group, Inc. is a Pennsylvania corporation, a bank holding company and a financial holding company under U.S. federal law. PNC is one of the largest diversified financial services companies in the United States based on assets, operating businesses engaged in retail banking, corporate and institutional banking, asset management and global fund processing services. PNC provides many of its products and services nationally and others in PNC s primary geographic markets located in Pennsylvania; New Jersey; the greater Washington, DC area, including Maryland and Virginia; Ohio; Kentucky; and Delaware. PNC also provides certain global fund processing services internationally. PNC stock (NYSE: PNC) is listed on the New York Stock Exchange. As of September 30, 2006, PNC had total consolidated assets of approximately $98.4 billion, total consolidated deposits of approximately $64.6 billion and total consolidated stockholders equity of approximately $10.8 billion. The principal executive offices of PNC are located at One PNC Plaza, 249 Fifth Avenue, Pittsburgh, Pennsylvania 15222-2707, and its telephone number is (412) 762-2000.

Additional information about PNC and its subsidiaries is included in documents incorporated by reference in this document. See Where You Can Find More Information on page [ ].

Mercantile Bankshares Corporation

Mercantile Bankshares Corporation is a Maryland corporation and a regional multibank holding company and a financial holding company headquartered in Baltimore, Maryland. It is comprised of 11 banks and a mortgage banking company. Eight banks are headquartered in Maryland, two are in Virginia and one is in Delaware. Mercantile s largest bank, Mercantile-Safe Deposit and Trust Company, represents approximately 45% of Mercantile s total assets and operates 40 offices in Maryland, 13 in Virginia, two in Washington, D.C. and one in Pennsylvania as of December 31, 2005. Nearly all of Mercantile s wealth management operations and specialized corporate banking services are provided by Mercantile-Safe Deposit and Trust Company. Through its affiliated banks, Mercantile provides a full range of banking services, including mortgage, trust and investment services, designed to meet the financial needs of its customers. Mercantile Bankshares Corporation stock (NASDAQ: MRBK) is listed on The NASDAQ Global Select Market. As of September 30, 2006, Mercantile had total consolidated assets of approximately $17.6 billion, including total consolidated deposits of approximately $12.8 billion, and total consolidated stockholders equity of approximately $2.4 billion. The principal executive offices of Mercantile are located at 2 Hopkins Plaza, Baltimore, Maryland 21201 and its telephone number is (410) 237-5900.

Additional information about Mercantile and its subsidiaries is included in documents incorporated by reference in this document. See Where You Can Find More Information on page [ ].

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PRO FORMA FINANCIAL INFORMATION

THE PNC FINANCIAL SERVICES GROUP, INC. AND

MERCANTILE BANKSHARES CORPORATION

The following unaudited pro forma condensed combined financial statements combine the historical consolidated financial statements of PNC and its subsidiaries and of Mercantile and its subsidiaries, as an acquisition by PNC of Mercantile using the purchase method of accounting and giving effect to the related pro forma adjustments described in the accompanying notes. The unaudited pro forma condensed combined balance sheet gives effect to the merger as if it had occurred on September 30, 2006. The unaudited pro forma condensed combined income statements for the nine months ended September 30, 2006 and the year ended December 31, 2005, give effect to the merger as if the merger had become effective at the beginning of each period presented.

The unaudited pro forma condensed combined financial statements included herein are presented for informational purposes only. This information does not reflect the benefits of the expected cost savings or opportunities to earn additional revenue and includes various estimates and may not necessarily be indicative of the financial position or results of operations that would have occurred if the merger had been consummated on the date or at the beginning of the period indicated or which may be attained in the future. The unaudited pro forma condensed combined financial statements and accompanying notes should be read in conjunction with and are qualified in their entirety by reference to the historical consolidated financial statements and related notes thereto of PNC and its subsidiaries and of Mercantile and its subsidiaries, such information and notes thereto are incorporated by reference herein.

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THE PNC FINANCIAL SERVICES GROUP, INC.

Pro Forma Condensed Combined Balance Sheet

At September 30, 2006

In millions, except par value	PNC as Reported (a) (Unaudited)	MRBK as Reported (b) (Unaudited)	Pro Forma Adjustments (Unaudited)		Notes	Pro Forma Combined (Unaudited)
Assets						
Cash and due from banks	$ 3,018	$ 318				$ 3,336
Federal funds sold and resale agreements	2,818	134				
Travelocity:						
Intangibles amortization	$ 1,614	$ 7,390	$ 3,617	$ 14,852		
Stock compensation	376	1,318	831	3,255		
Total Travelocity	$ 1,990	$ 8,708	$ 4,448	$ 18,107		
Sabre Airline Solutions:						
Intangibles amortization	$ 563	$	$ 1,133	$		
Total Sabre Airline Solutions	$ 563	$	$ 1,133	$		
Corporate:						
Stock compensation		3		17		
Total Corporate	$	$ 3	$	$ 17		
Total operating income adjusting items	$ 6,955	$ 16,060	$ 15,192	$ 29,641		
Consolidated operating income (loss):						
Sabre Travel Network	$ 67,134	$ 81,959	$ 143,213	$ 162,277		
Travelocity	4,554	935	(9,684)	(9,929)		
Sabre Airline Solutions	11,097	5,593	20,437	4,971		
Net corporate allocations	321	(44)	334	612		
Total	$ 83,106	$ 88,443	$ 154,300	$ 157,931		

Segment operating income for Travelocity for 2005 includes the impact of changes in the timing of recognizing advertising expenses within the fiscal year. See Note 2.

8. Supplemental Guarantor/Non-Guarantor Financial Information

Certain obligations of Sabre Holdings have been solely guaranteed by its 100% owned operating subsidiary, Sabre Inc. There are currently no restrictions on Sabre Holdings ability to obtain funds from Sabre Inc. in the form of a dividend or loan other than typical dividend requirements under Delaware law. Additionally, there are no significant restrictions on Sabre Inc. s ability to obtain funds from its direct or indirect subsidiaries other than those that would exist under state or foreign law. Sabre Inc. is the sole direct subsidiary of Sabre Holdings. All other subsidiaries are direct or indirect subsidiaries of Sabre Inc. These other subsidiaries are all included in the non-guarantor financial statements. The following financial information presents condensed consolidating balance sheets, statements of income and statements of cash flows for Sabre Holdings, Sabre Inc. and non-guarantor subsidiaries. The information has been presented as if Sabre Holdings accounted for its ownership of Sabre Inc., and Sabre Inc. accounted for its ownership of the non-guarantor subsidiaries, using the equity method of accounting. Certain reclassifications have been made to the 2004 financial statements to conform to the 2005 presentation. These reclassifications are not material, either individually or in the aggregate, to our financial statements.

Sabre Inc. conducts the domestic operations of both the Sabre Travel Network and Sabre Airline Solutions segments. The operations of the Travelocity segment, the principal international operations of the Sabre Travel Network segment as well as the principal international operations of Sabre Airline Solutions, are conducted by the non-guarantor subsidiaries.

Sabre Inc. and certain non-guarantor subsidiaries are parties to various intercompany agreements that affect the amount of operating expenses reported in the following condensed consolidating statements of income. Among other things, fees are paid by Sabre Inc. to a non-guarantor subsidiary relating to the use of trademarks, tradenames, etc. owned by a non-guarantor subsidiary; incentive and marketing payments are made by Sabre Inc. to non-guarantor subsidiaries relating to the use and distribution of the *Sabre* system; and payments are made by non-guarantor subsidiaries to Sabre Inc. for access to the *Sabre* system under the terms of these agreements. During the six months ended June 30, 2005 and 2004, Sabre Inc. recognized operating expenses in connection with these agreements totaling approximately $165 million and $120 million, respectively. These amounts, and the corresponding amounts recognized by the non-guarantor subsidiaries are eliminated in consolidation.

UNAUDITED CONSOLIDATING CONDENSED BALANCE SHEETS

JUNE 30, 2005

(in thousands)

	Sabre Holdings	Sabre Incorporated	Non-Guarantor Subsidaries	Eliminations	Sabre Consolidated
Assets					
Current Assets					
Cash and marketable securities	$	$ 747,509	$ 56,531	$	$ 804,040
Accounts receivable, net		289,677	141,664		431,341
Intercompany accounts receivable (payable)		(267,289)	267,289		
Other current assets		33,837	75,623		109,460
Total current assets		803,734	541,107		1,344,841
Property and equipment, net		342,635	53,471		396,106
Investment in subsidiaries	751,829	1,460,105		(2,211,934)	
Intercompany notes	1,303,205	(1,303,205)			
Investment in joint ventures		4,171	153,954		158,125
Goodwill and intangible assets, net		11,768	1,003,463		1,015,231
Other assets, net	14,904	119,254	71,971		206,129
Total assets	$ 2,069,938	$ 1,438,462	$ 1,823,966	$ (2,211,934)	$ 3,120,432
Liabilities and stockholders equity					
Current liabilties					
Accounts payable and net rate program related liabilities	19	102,634	192,622		295,275
Accrued compensation and related benefits		38,116	18,163		56,279
Other current accrued liabilities	9,617	169,646	164,724		343,987
Total current liabilities	9,636	310,396	375,509		695,541
Pensions and other postretirement benefits		154,124	568		154,692
Other liabilities	1,121	59,791	(38,748)		22,164
Minority interests			11,456		11,456
Long-term capital lease obligation		162,322			162,322
Public and other notes payable	423,202		15,076		438,278
Total stockholders equity	1,635,979	751,829	1,460,105	(2,211,934)	1,635,979
Total liabilities and stockholders equity	$ 2,069,938	$ 1,438,462	$ 1,823,966	$ (2,211,934)	$ 3,120,432

UNAUDITED CONSOLIDATING CONDENSED BALANCE SHEETS

DECEMBER 31, 2004

(in thousands)

	Sabre Holdings	Sabre Incorporated	Non-Guarantor Subsidaries	Eliminations	Sabre Consolidated
Assets					
Current Assets					
Cash and marketable securities	$	$ 766,401	$ 70,623	$	$ 837,024
Accounts receivable, net		236,160	113,461		349,621
Intercompany accounts receivable (payable)		(159,414)	159,414		
Other current assets		22,288	64,582		86,870
Total current assets		865,435	408,080		1,273,515
Property and equipment, net		340,964	46,377		387,341
Investment in subsidiaries	692,123	1,331,046		(2,023,169)	
Intercompany notes	1,361,035	(1,361,035)			
Investment in joint ventures		4,348	171,901		176,249
Goodwill and intangible assets, net		12,209	976,391		988,600
Other assets, net	15,200	109,312	67,760		192,272
Total assets	$ 2,068,358	$ 1,302,279	$ 1,670,509	$ (2,023,169)	$ 3,017,977
Liabilities and stockholders equity					
Current liabilties					
Accounts payable and net rate program related liabilities	7,790	105,146	122,584		235,520
Accrued compensation and related benefits		64,386	16,062		80,448
Other current accrued liabilities	8,504	128,412	155,408		292,324
Total current liabilities	16,294	297,944	294,054		608,292
Pensions and other postretirement benefits		153,694	843		154,537
Other liabilities	1,350	(2,596)	24,347		23,101
Minority interests			5,143		5,143
Long-term capital lease obligation		161,114			161,114
Public and other notes payable	424,233		15,076		439,309
Total stockholders equity	1,626,481	692,123	1,331,046	(2,023,169)	1,626,481
Total liabilities and stockholders equity	$ 2,068,358	$ 1,302,279	$ 1,670,509	$ (2,023,169)	$ 3,017,977

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF INCOME

FOR THE THREE MONTHS ENDED JUNE 30, 2005

(in thousands)

	Sabre Holdings	Sabre Incorporated	Non-Guarantor Subsidaries	Eliminations	Sabre Consolidated
Revenues	$	$ 397,375	$ 352,767	$ (130,887)	$ 619,255
Operating expenses	880	346,064	320,092	(130,887)	536,149
Operating income (loss)	(880)	51,311	32,675		83,106
Other income (expense)					
Interest income	24,116	4,633	6,351	(29,000)	6,100
Interest expense	(5,499)	(31,403)	(486)	29,000	(8,388)
Income from subsidiaries	32,266	24,409		(56,675)	
Other, net		(9,611)	605		(9,006)
Total other income (expense)	50,883	(11,972)	6,470	(56,675)	(11,294)
Income before provision for income taxes	50,003	39,339	39,145	(56,675)	71,812
Provision for income taxes	6,116	7,073	14,736		27,925
Net income	$ 43,887	$ 32,266	$ 24,409	$ (56,675)	$ 43,887

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF INCOME

FOR THE THREE MONTHS ENDED JUNE 30, 2004

(in thousands)

	Sabre Holdings	Sabre Incorporated	Non-Guarantor Subsidaries	Eliminations	Sabre Consolidated
Revenues	$	$ 375,303	$ 305,535	$ (129,935)	$ 550,903
Operating expenses	1,027	322,995	268,373	(129,935)	462,460
Operating income (loss)	(1,027)	52,308	37,162		88,443
Other income (expense)					
Interest income	24,282	2,370	2,921	(26,267)	3,306
Interest expense	(4,166)	(28,214)	(318)	26,267	(6,431)
Income from subsidiaries	46,363	27,076		(73,439)	
Other, net		6,578	(521)		6,057
Total other income	66,479	7,810	2,082	(73,439)	2,932
Income before provision for income taxes	65,452	60,118	39,244	(73,439)	91,375
Provision for income taxes	6,515	13,755	12,168		32,438
Net income	$ 58,937	$ 46,363	$ 27,076	$ (73,439)	$ 58,937

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UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF INCOME

FOR THE SIX MONTHS ENDED JUNE 30, 2005

(in thousands)

	Sabre Holdings	Sabre Incorporated	Non-Guarantor Subsidiaries	Eliminations	Sabre Consolidated
Revenues	$	$ 798,648	$ 639,561	$ (237,066)	$ 1,201,143
Operating expenses	1,826	670,533	611,550	(237,066)	1,046,843
Operating income (loss)	(1,826)	128,115	28,011		154,300
Other income (expense)					
Interest income	50,238	7,854	8,195	(55,818)	10,469
Interest expense	(10,657)	(60,387)	(776)	55,818	(16,002)
Income from subsidiaries	76,831	35,439		(112,270)	
Other, net		(9,757)	21,954		12,197
Total other income (expense)	116,412	(26,851)	29,373	(112,270)	6,664
Income before provision for income taxes	114,586	101,264	57,384	(112,270)	160,964
Provision for income taxes	13,018	24,433	21,945		59,396
Net income	$ 101,568	$ 76,831	$ 35,439	$ (112,270)	$ 101,568

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF INCOME

FOR THE SIX MONTHS ENDED JUNE 30, 2004

(in thousands)

	Sabre Holdings	Sabre Incorporated	Non-Guarantor Subsidiaries	Eliminations	Sabre Consolidated
Revenues	$	$ 766,518	$ 574,156	$ (250,018)	$ 1,090,656
Operating expenses	2,293	659,765	520,685	(250,018)	932,725
Operating income (loss)	(2,293)	106,753	53,471		157,931
Other income (expense)					
Interest income	50,047	4,883	5,335	(53,724)	6,541
Interest expense	(8,316)	(57,648)	(618)	53,724	(12,858)
Income from subsidiaries	75,995	40,311		(116,306)	
Other, net		6,228	257		6,485
Total other income (expense)	117,726	(6,226)	4,974	(116,306)	168
Income before provision for income taxes	115,433	100,527	58,445	(116,306)	158,099
Provision for income taxes	13,459	24,532	18,134		56,125
Net income	$ 101,974	$ 75,995	$ 40,311	$ (116,306)	$ 101,974

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2005

(in thousands)

		Sabre Holdings		Sabre Incorporated		Non-Guarantor Subsidiaries		Eliminating Entries		Sabre Consolidated
Operating Activities										
Cash provided by operating activities	$		$	141,084	$	13,291	$		$	154,375
Investing Activities										
Additions to property and equipment				(25,411)		(15,198)				(40,609)
Net sales of marketable securities				13,088		18,309				31,397
Proceeds from sale of investment						26,013				26,013
Loans and investments to joint venture partners						(12,538)				(12,538)
Acquisitions (net of cash acquired)				(41,708)		(25,065)				(66,773)
Investments in subsidiaries, net										
Other investing activities				(10,000)						(10,000)
Cash used for investing activities				(64,031)		(8,479)				(72,510)
Financing Activities										
Proceeds from exercise of common stock		3,834								3,834
Dividends paid		(23,530)								(23,530)
Contributions/(distributions) from affiliates, net		82,909		(82,909)						
Purchases of treasury stock		(63,213)								(63,213)
Other financing activities, net				(1,200)						(1,200)
Cash used for financing activities				(84,109)						(84,109)
Increase (decrease) in cash				(7,056)		4,812				(2,244)
Cash at beginning of period				7,467		42,204				49,671
Cash at end of period	$		$	411	$	47,016	$		$	47,427

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2004

(in thousands)

	Sabre Holdings	Sabre Incorporated	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Operating Activities					
Cash provided by operating activities	$	$ 258,242	$ 28,109	$	$ 286,351
Investing Activities					
Additions to property and equipment		(25,752)	(10,156)		(35,908)
Net sales/(purchases) of marketable securities		(109,590)	1,662		(107,928)
Loans and investments to joint venture partners			(32,934)		(32,934)
Other investing activities			(5,000)		(5,000)
Cash used for investing activities		(135,342)	(46,428)		(181,770)
Financing Activities					
Proceeds from exercise of common stock	10,802				10,802
Dividends paid	(20,906)				(20,906)
Contributions/(distributions) from affiliates, net	112,029	(121,708)	9,679		
Purchases of treasury stock	(101,925)				(101,925)
Other financing activities, net		(824)	(888)		(1,712)
Cash provided by (used for) financing activities		(122,532)	8,791		(113,741)
Increase (decrease) in cash		368	(9,528)		(9,160)
Cash at beginning of period		10,969	29,893		40,862
Cash at end of period	$	$ 11,337	$ 20,365	$	$ 31,702

9. **Subsequent Events**

Acquisition of lastminute.com

On May 12, 2005, we announced that we had reached an agreement on the terms of a recommended cash acquisition (the lastminute.com acquisition) of lastminute.com plc (lastminute.com) at a price of 165 pence in cash per lastminute.com share. On July 19, 2005, the High Court granted an Order sanctioning the Scheme of Arrangement (Scheme) under which we have acquired all of the shares of lastminute.com at a price of 165 pence per share, or approximately £577 million ($1,020 million). The corresponding Order was filed July 20, 2005 and registered at the Companies Registry in England and Wales. Accordingly, the Scheme is now effective and all shares of lastminute.com held by persons other than us have been cancelled. lastminute.com s proposal to redeem its EUR 102,582,000 6% Convertible Bonds due 2008 (the Bonds) for EUR 1,116.58 per EUR 1,000 principal amount of Bonds on August 3, 2005 is also unconditional now that the scheme is effective and these bonds have been redeemed as a part of the lastminute.com acquisition. Our expanded worldwide Travelocity organization (including lastminute.com) will have greater global scale, allowing us to offer to our supplier partners a greater geographical reach with a larger number of potential buyers. This is expected to give us a greater ability to obtain enhanced travel deals that we can offer consumers.

The aggregate cost of the acquisition was approximately £584 million (approximately $1,034 million) which includes an equity value of £577 million ($1,020 million), debt of £79 million (approximately $138 million) for the bonds redeemed as noted above and is net of cash in bank and on hand of approximately £72 million (approximately $125 million). We used $359 million of available cash and marketable securities ($234 million, net of cash acquired) to fund the acquisition and incurred $800 million in additional indebtedness under the Bridge Facility discussed below under *Bridge Financing Arrangement.* We plan to refinance a portion of the borrowings under the Bridge Facility with borrowings under our revolving credit facility. We plan to refinance the remaining borrowings under the Bridge Facility with long-term financing in the fourth quarter of 2005 or early in 2006.

As noted in Footnote 6, we entered into forward contracts to lock in the U.S. Dollar purchase price for the acquisition of lastminute.com. On August 1, 2005, we settled these forward contracts and delivered the foreign currency to the appropriate payment agents in the U.K. for further payment to the shareholders and bond holders of lastminute.com. The gain on these forwards, due to the change in the exchange rate from the time we entered the forward contracts to the time they settled on August 1, 2005, was immaterial.

The acquisition will be included in our Consolidated Income Statement from the date of acquisition, July 20, 2005. The assets acquired and liabilities assumed will be recorded at their estimated fair values as determined by management based on an independent valuation on the net assets acquired, including intangible assets. We expect that the excess of the purchase price over the estimated fair value of the net assets acquired to be a significant portion of the total purchase price. The recorded goodwill will be deductible for income tax purposes.

Prior to the acquisition, a wholly owned subsidiary of lastminute.com was made aware by Worldspan Services Limited L.P. (Worldspan) of potential claims arising out of the relationship between lastminute.com and Worldspan for the provision of global distribution services. The claims are material and relate to fees that lastminute.com is alleged to owe Worldspan. lastminute.com disputes this potential liability and is in discussions with Worldspan to resolve these potential claims. ***Because this claim existed at the date we acquired lastminute.com, we will analyze this potential liability in conjunction with our purchase price allocation of fair values of assets and liabilities and in accordance with Statement of Financial Accounting Standards No. 5, Accounting for Contingencies.***

Bridge Financing Arrangement

On May 12, 2005, we entered into an $800 million, unsecured, multi-draw bridge loan agreement (the Bridge Facility) that matures on August 12, 2006, in order to provide temporary financing in connection with the lastminute.com acquisition and to satisfy legal requirements for certainty of funding for the acquisition. On July 22, 2005, we entered into an amendment to the Bridge Facility whereby all the rights and obligations of Sabre Inc. under the Bridge Facility were assumed by Sabre Holdings and Sabre Inc. was discharged from its obligations thereunder.

Effective August 1, 2005, we borrowed $800 million under the Bridge Facility in order to partially finance the purchase of the shares of lastminute.com in connection with the lastminute.com acquisition.

The interest rate on borrowings under the Bridge Facility is variable, based at our discretion on either the London Interbank Offered Rate (LIBOR) plus a borrowing spread or the prime rate, and is sensitive to our credit rating. The LIBOR based interest rate at our current credit rating is equal to approximately 4%. The Bridge Facility requires us to pay, quarterly and upon termination of the Bridge Facility, a commitment fee based on the preceding quarter s unused portion of the Bridge Facility multiplied by a commitment fee percentage specified in the Bridge Facility. We are also required to pay other fees based on the Bridge Facility amount. These fees are not material.

We may prepay all or any part of the Bridge Facility without prepayment penalty, other than any breakage costs associated with the early repayment of loans bearing interest based upon LIBOR. We would be required to repay borrowings under the Bridge Facility with net cash proceeds we receive from (i) the issuance of capital stock and indebtedness for money borrowed with a maturity in excess of one year (excluding, among other things, borrowings under our existing revolving credit agreement) and (ii) asset sales with proceeds of more than $200 million.

The Bridge Facility contains other covenants, representations, terms and conditions that are typical for a bridge credit facility of this type which, among other things, restricts our ability to incur additional debt and limits our ability to pay in excess of $150 million during the term of the Bridge Facility as dividends or to repurchase our stock.

As of June 30, 2005, we were in compliance with all covenants under the Bridge Facility including the following financial covenants:

Covenant		**Requirement**		**Level at June 30, 2005**
Consolidated Leverage Ratio (Debt to EBITDA)		5.0 to 1		1.4 to 1
Consolidated Net Worth	$	1.252 billion	$	1.6 billion

On August 1, 2005, we used approximately $359 million in cash ($234 million, net of cash acquired) and incurred approximately $800 million in additional indebtedness under the Bridge Facility. Although this materially increases our Consolidated Leverage Ratio, we believe we continue to be in compliance with the financial and other covenants under the Bridge Facility.

As a result of the additional debt incurred on August 1, 2005 to fund the lastminute.com deal, Standard & Poor s changed our credit rating from BBB+ to BBB. That is still an investment grade credit rating and is not anticipated to have a material impact on our borrowing cost.

Moody s Investors Service is still evaluating a potential change in our current credit rating of Baa2, which is also investment grade.

Revolving Credit Facility

On July 22, 2005, in order to facilitate the consummation of the lastminute.com acquisition and to provide additional liquidity and flexibility in our capital structure, we entered into certain amendments to an existing revolving credit agreement (the Revolver) with Bank of America, N.A., as agent. Under the amendments, Sabre Holdings assumed all of the rights and obligations of Sabre Inc. under the Revolver and Sabre Inc. was discharged from its obligations thereunder. The amendments also include, among other things: (i) amendments to certain financial and negative covenants (including amendments to provide us more flexibility under the Consolidated Leverage Ratio covenant, as shown in the table below, and amendments that place additional restrictions on the ability of our subsidiaries to incur indebtedness), (ii) amendments that prohibit us from using proceeds from the Revolver to repay the Bridge Facility to the extent such proceeds represent more than 50% of the then aggregate committed amount of the lenders under the Revolver, (iii) amendments that increase the aggregate amount committed by those lenders to $360 million, and (iv) amendments that allow us to request a future increase of the aggregate amount committed by the lenders under the Revolver to as much as $500 million.

Our new covenants under the amended revolving credit agreement are as follows:

As amended on July 22, 2005	**Requirement**
Consolidated Leverage Ratio (Debt to EBITDA):	
July 22, 2005 through March 30, 2006	3.75 to 1 maximum
June 30, 2006 through September 30, 2006	3.50 to 1 maximum
December 31, 2006 through March 31, 2007	3.25 to 1 maximum
June 30, 2007 and thereafter	3.00 to 1 maximum

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

SABRE HOLDINGS CORPORATION

RESULTS OF OPERATIONS

The following discussion and analysis contains forward-looking statements about trends, uncertainties and our plans and expectations of what may happen in the future. Forward-looking statements are based on a number of assumptions and estimates that are inherently subject to significant risks and uncertainties, and our results could differ materially from the results anticipated by our forward-looking statements as a result of many known or unknown factors, including, but not limited to, those factors discussed below in this Item under the sub-heading Risk Factors.

Overview of Business

We operate our business through the following business segments:

Sabre Travel Network: Our Sabre Travel Network segment markets and distributes travel-related products and services through the travel agency and corporate channels. Travel agencies, both online and brick and mortar, subscribe to our services. Sabre Travel Network primarily generates revenues from transaction fees charged to airlines and non-air travel suppliers who distribute their products and services through the *Sabre* system. Sabre Travel Network markets the *Sabre* GDS to travel suppliers, travel agency subscribers (online and brick and mortar) and corporations. Due to the changing nature of our business, a transaction will now be defined as any travel reservation that generates a fee paid directly to us including but not limited to the following: traditional booking fees paid by travel suppliers, non-traditional transaction fees paid by travel suppliers, transaction fees paid by travel agency subscribers, and transaction fees paid by corporations related to our online booking tool. Our services provide travel agency subscribers information about, and the ability to reserve for purchase travel-related products and services from airlines, hotels, car rental companies, cruise lines and others. We also provide travel agency office automation tools, enable travel agencies to provide services via the Internet and provide reservation management, distribution and technology services to hotel properties.

Travelocity: Our Travelocity segment markets and distributes travel-related products and services directly to individuals, including leisure travelers and business travelers, through Travelocity websites and contact centers, and websites owned by its supplier and distribution partners. Travelocity customers can access offerings, pricing and information about airlines, hotels, car rental companies, cruise lines, vacation and last-minute travel packages from *Site 59*® and lastminute.com and other travel-related services such as show tickets and tours from *Showtickets.com™*. For business travelers, *Travelocity Business* provides the integrated online corporate travel technology and full-service offering of our *GetThere*® product along with the online expertise of Travelocity. For corporations, Travelocity Business offers a full service corporate travel agency and GetThere provides a corporate online travel reservation system that works in conjunction with any travel agency a company chooses.

Travelocity facilitates transactions between travel suppliers and consumers for the booking of, and payment for, travel accommodations. Travelocity generates revenue from providing such facilitation services equal to the total amount paid by the customer for products and services, minus its payment to the travel supplier. Travelocity also generates revenues from commissions or transaction fees from travel suppliers for the purchase of travel products and services pursuant to reservations made through our system. Additionally, Travelocity revenues include service fees charged to customers and advertising revenues.

Sabre Airline Solutions: Sabre Airline Solutions is a global leader in providing passenger management solutions, software products and related services, and consulting services to help airlines simplify operations and lower costs. We provide airline reservations, inventory and check-in hosting solutions that help airlines address the challenge of building and retaining customer loyalty through enhanced customer centric offerings and service while also reducing costs. We also supply the decision-support software and technology necessary for airlines to improve profitability, increase revenue, streamline operations and improve workflow. We also offer a complete range of consulting services to the airline industry, ranging from one time to extended engagements. Typical engagements include projects such as achieving the necessary standards to join an alliance, preparing for privatization and optimizing current operations. Clients include airlines, airports, manufacturers and governments, as well as individuals, travel agencies and members of the financial community.

In the six months ended June 30, 2005, approximately 65.4% of our revenue was generated from Sabre Travel Network, 24.6% from Travelocity and 10.0% from Sabre Airline Solutions based on segment results that include intersegment revenues. For the six months ended June 30, 2004, revenues (including intersegment revenue) as a percentage of total revenues were 69.6% for Sabre Travel Network, 20.2% for Travelocity and 10.2% for Sabre Airline Solutions.

Business Trends

Potential effects of the following trends, events and uncertainties are discussed in *Risk Factors*.

Transaction Volumes. During the six months ended June 30, 2005, Sabre Travel Network experienced transaction growth of 4.0% compared to the first six months of 2004 due primarily to an increase in non-traditional transactions. See *Business Trends - Changing our Sabre Travel Network Business Model*

Factors Influencing the Travel Industry, Particularly Airlines. Our revenues are highly dependent on the travel and transportation industries, and particularly on airlines. Most of our revenue is derived from airlines, hotel operators, car rental companies, cruise operators, and other suppliers in the travel and transportation industries. Our revenue increases and decreases with the level of travel and transportation transactions processed by our systems. Consequently, our revenues are highly subject to declines in, or disruptions to, travel and transportation due to factors entirely out of our control, such as ongoing travel security concerns due to potential terrorist attacks. In addition, we depend on a relatively small number of major airlines for a significant portion of our revenues. Several of these airlines are experiencing financial difficulty, some (including U.S. Airways Group Inc. and America West Holdings Corp.) are considering consolidation, some (including United Air Lines, Inc., U.S. Airways Group, Inc. and ATA Holdings Corporation) have sought bankruptcy protection and still others may consider bankruptcy relief. See *Risk Factors Our Revenues Are Highly Dependent* .

Supplier Efforts to Control Travel Distribution. Airlines have been working aggressively for several years to divert transactions away from GDS networks and towards alternative travel distribution channels, including websites that they control and online travel agencies that book directly with those airlines. See *Risk Factors Some Travel Suppliers are Seeking Alternative Distribution Models* . The efforts of suppliers to divert transactions away from independent distributors (such as online and conventional travel agencies using our *Sabre* GDS) towards supplier-direct channels (such as supplier-controlled websites and call centers) are referred to as channel shift. Over the last two years, we have experienced a moderation in the rate of channel shift, which we attribute partly to our current pricing options for suppliers, discussed below, and partly due to a rebound in corporate travel. The rate of channel shift varies quarter-to-quarter but in general is below pre-2003 levels, which is an encouraging indicator, but it is not clear if this pattern will continue over the long-term.

Competition and Consolidation. The marketplace for travel distribution is intensely competitive. We routinely face new competitors and new methods of travel distribution. Suppliers and third parties seek to create distribution systems that book directly with travel suppliers at a reduced cost. These alternative distribution channels include limited travel distributors, or LTDs. These systems are not global and offer a limited subset of transactions from a limited subset of air carriers in one market segment. In addition, these systems still rely on the scale and functionality of a GDS for a complete travel distribution solution, as they do not offer a comprehensive system and do not have the service and support infrastructure for travel management companies or corporations. They require the integration of a new, stand alone system into most existing agency or corporate booking tool workflows. Many of these alternative travel distribution channels, such as the LTDs, are in start-up or developing mode, are well-financed and have yet to fully define their functionality and costs (*See Supplier Efforts to Control Travel Distribution*, above). In addition, new competitors are entering the travel marketplace. Both established and start up search engine companies are attempting to enter the travel marketplace by leveraging search technology to aggregate travel search results across supplier, travel agent and other websites. These search engines, LTDs and alternative travel distribution channels may have the effect of diverting customers from our online sites and our *Sabre* GDS, putting pressure on our revenues, pricing and operating margins. See *Risk Factors Some Travel Suppliers Are Seeking....* We also face consolidation among suppliers, travel marketing and distribution competitors, and online and conventional travel agencies, which may offer them negotiating leverage and other advantages of scale and may cause an increase in competition for the resulting consolidated business. See *Risk Factors - We face competition* and *Risk Factors Consolidation...*

Pricing Options for Suppliers. Primarily to ensure that our customers had access to the most comprehensive airline fares, in 2002 and 2003, we introduced alternative booking fee pricing options, such as the *Direct Connect® Availability* 3-Year Pricing Option (DCA 3-Year Option), to airlines that participate in the *Sabre* GDS. Through the DCA 3-Year Option, participating airlines committed to the highest level of participation in the *Sabre* system for three years. Participating airlines provide all *Sabre* GDS users with broad access to schedules, seat availability and published fares, including web fares and other promotional fares but excluding certain fares such as opaque fares (where the airline s identity is not disclosed until after the sale) and private discounts. Participating airlines also furnish generally the same customer perquisites and amenities to passengers booked through the *Sabre* GDS as those afforded through other GDS s and websites. Airlines selecting this option under their *Sabre* GDS participating carrier agreements receive a discount from our standard DCA booking fee rates which is fixed for the term of the agreement. Our DCA 3-Year Option agreements prepared us for GDS industry deregulation in the United States, by giving us access to virtually all of a participating carrier s content and eliminating fare confusion in the marketplace. See *Computer Reservation System Industry Regulation* below and *Risk Factors Some Travel Suppliers Are Seeking....*

With the deregulation of the GDS industry in mid-2004, (described below under *Computer Reservation System Industry Regulation*), we have new flexibility to price our services based upon a variety of factors. We have already implemented new pricing models for some suppliers. For example, during the second quarter of 2004, we completed two opt-in agreements with international carriers that are generally similar to our DCA 3-Year Option agreements. For bookings created in the participating carriers home countries, these opt-in agreements offer a deeper discount than under the DCA 3-Year Option, which offers participating airlines smaller discounts across multiple regions. These agreements provide discounts only to those *Sabre* GDS subscribers that accept lowered customer incentive rates. As of June 30, 2005, approximately 50% of our global direct air bookings were subject to our current discount pricing options (DCA 3-Year Option and Opt-In agreements).

We are evaluating various other options for pricing our services to suppliers, and are pursuing additional options such as pricing that includes services from our Sabre Airline Solutions segment and expanding our merchandizing efforts within the *Sabre* GDS. Pricing options might be offered to airlines according to their operational needs, such as pricing that varies with the volume of an airline s transactions through the *Sabre* GDS or pricing that differs between long-haul or short-haul trips. In some cases we may approach airlines with pricing options from any combination of our business units. We plan to offer airlines a choice of multiple pricing schedules, and we expect that each new airline participation agreement will differ in many ways, including by price. We believe that airlines will see the advantages that may be inherent in moving quickly to enter into these new, more customizable relationships with us. It is difficult to predict with certainty, in a recently deregulated environment, the impact of new pricing models on our revenues. It is our goal to maintain, over a several year period, a neutral impact to the average unit revenue (including merchandizing revenue) in the Sabre Travel Network business. If certain pricing models were to gain further traction, we could see a reduction in our average unit revenue which could be partially offset by reduced expenses. Our goal is to have new agreements in place with many airlines before the expiration of our DCA 3-Year Option agreements in 2006. Our DCA 3-Year Option agreement with US Airways, the only such agreement with a major U.S. airline that had a 2005 expiration date, was extended for one year beginning in October of 2005. Regardless of the outcome of these pricing models, it is our intent to reduce costs in the Sabre Travel Network business. *See Risk Factors Adverse Changes In Or Interruptions To...*

Changing our Sabre Travel Network Business Model. We are also taking actions both to strengthen our core *Sabre* GDS business with enhanced content and capabilities and to take advantage of the opportunities available in merchandising as we benefit from the insight we gain from having travel distribution and travel marketing assets in one integrated portfolio:

Historically, the vast majority of our travel distribution revenues have been derived from transaction fees paid by travel suppliers to our Sabre Travel Network unit. Sabre Travel Network pays incentives to its travel agency customers for bookings through the *Sabre* GDS as a cost of revenue. Recently, we have negotiated limited arrangements that depart from our traditional business model. For example, we have entered into arrangements under which the travel suppliers pay our travel agency customer, which in turn pays a transaction fee to our Sabre Travel Network unit. In these arrangements, we only have an agreement with the travel agency for its transactions with participating suppliers. We are evaluating the desirability of more of these agreements. See *Pricing Options for Suppliers* above. Some of these non-traditional transactions may have a lower rate per transaction than a traditional booking fee, therefore, the overall average revenue per transaction may be lower as these non-traditional transactions increase. *See Risk Factors Adverse Changes In....*

Due to the changing nature of our business, we now define a transaction as any travel reservation that generates a fee paid directly to us including but not limited to the following: traditional booking fees paid by travel suppliers, non-traditional transaction fees paid by travel suppliers, transaction fees paid by travel agency subscribers, and transaction fees paid by corporations related to our online booking tool.

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During the second quarter of 2005, Sabre Travel Network experienced growth in travel agency incentives, as projected, and absorbed most of the $3 million severance charge described below under *Cost Reductions and Expense Savings*. This, combined with our investments in new emerging businesses (such as the *Jurni Network*™ consortia) put pressure on the Sabre Travel Network margin this quarter.

We are continuing to build on the actions we took in 2004 to enhance our competitive position by reducing our operating expenses. See *Cost Reductions and Expense Savings* below. We continue to seek ways to provide more flexible and cost-effective distribution options to our customers.

In 2004, we rolled out several new features for our *Jurni Networ*k offering, including the new *Jurni*® *Custom Trip*™ packaging capabilities from Travelocity, *Agent 59*® which incorporates last minute travel offerings from *Site59.com*® and *JurniCruise*TM which provides automated shopping and booking capability for cruises. All of the features are available to *Jurni* agents in our *InternetView*™ point-of-sale tool.

During the third quarter of 2004, we introduced the *Hotel Spotlight* program which offers premium marketing opportunities to hoteliers through the *Sabre* GDS.

In 2004 we launched *MySabre*™, a new web-based agent booking portal which provides agents and suppliers with new merchandising opportunities at the point of sale.

In January of 2005, we acquired SynXis Corporation (SynXis), which provides *SynXis* reservation management, distribution and technology services to approximately 6,000 hotel properties, to further expand the range of services we offer to hotels.

During the second quarter of 2005, we launched *SabreSurround*™, a bundled offering that includes services like *Hotel Spotlight*, Sabre Media, targeted email marketing campaigns and our Agent Reward loyalty program.

Investments in Travelocity. The development of Travelocity continues to be a strategic focus for us. We are investing and continue to look for ways to invest in developing products and segments that we believe offer rapid growth opportunities, such as in the business-direct segment and online distribution in Europe and Asia. For example:

In January 2005, Travelocity entered into a put option agreement pursuant to which it may gain control of 100% of Zuji Holdings Limited (Zuji), a joint venture operating in the Asia Pacific region in which we currently hold a 13%

equity stake through direct and indirect ownership and which we account for under the equity method. In the third or fourth quarter of 2005, we expect to either loan additional funds or may possibly choose to participate in future anticipated capital calls of Zuji. Without a pro rata contribution from the other equity holders, we may be required to consolidate Zuji under the guidance of the Financial Accounting Standards Board (FASB) Interpretation No. 46R, *Consolidation of Variable Interest Entities.* Initially, this consolidation would have a negative affect on Travelocity s operating income, although we believe that the impact to net earnings, including minority interests, would be immaterial. We also expect significant growth from Zuji as adoption to online travel continues to grow in Asia.

On July 20, 2005, we completed a cash acquisition of lastminute.com, a leading online travel and leisure brand in Europe that will become the lead brand in Europe for Travelocity.

Our expanded worldwide Travelocity organization (including lastminute.com) has greater global scale, meaning we can now offer greater reach to our travel supplier partners in terms of geographies and number of potential buyers. This is expected to give us a greater ability to secure even better travel deals that we can currently offer consumers.

We will also be able to offer travelers a greater range of international options on each of our sites. An immediate benefit will be offering the wide range of hotels in Travelocity s net rate hotel program to lastminute.com customers. lastminute.com customers will get a greater range of U.S. and international travel options, and over time, Travelocity should gain more European travel choices. Sabre Travel Network also expects to offer its network of travel agency subscribers expanded European travel options as a result of the acquisition, expanding distribution reach for lastminute.com travel suppliers. See *Risk Factors* *We may be unsuccessful in pursuing and integrating business combinations*

Yahoo! Agreement. We have an agreement with Yahoo! whereby we are the exclusive air, car and hotel booking engine on Yahoo! Travel. That agreement was set to expire on December 31, 2005. In July 2005, we agreed with Yahoo! to extend our relationship through December 31, 2006. Travelocity will continue to be the exclusive provider of air, car, and hotel products to Yahoo! Travel. Our fees for 2006 will consist of a fixed payment of $26 million, which includes payments for purchased advertising and corporate services; plus we will pay a productivity component, whereby Yahoo! is paid a percentage of the transaction services revenue generated through the Yahoo! network. $10 million of the $26 million fixed fee could be less depending on revenue performance compared to 2005 levels, and a formula agreed to between us and Yahoo!. We believe this variability provides necessary downside protections into the contract extension to preserve the value of our investment in that partnership. The revised terms also allow Yahoo! to continue and expand in the travel search arena throughout the Yahoo! network. Pursuant to this agreement, Travelocity has decided to not participate in Yahoo! s Farechase metasearch model under either the Travelocity brand or the Yahoo! travel brand.

Net Rate Hotel Program. In an effort to provide additional choices to consumers, Travelocity is increasingly promoting our net rate hotel program, commonly referred to in the industry as a merchant model hotel program due to the fact that Travelocity is the merchant of record for credit card purposes. Under the net rate program, we facilitate transactions between travel suppliers and travelers for the booking of and payment for travel accommodations. To facilitate the provision of travel accommodations to travelers, we enter into agreements with travel suppliers for the right to market their products, services and other content offerings at pre-determined net rates. Net rate travel offerings can include air travel, hotel stays, and dynamically packaged combinations (via Travelocity the *TotalTrip*™ and Last Minute Deals offerings). We market those offerings to travelers at a price that includes an amount sufficient to pay the travel supplier for its charge for providing the travel accommodations, along with any applicable taxes we expect will be invoiced to us by the travel supplier on that charge, as well as additional amounts representing our service fees. For this type of business model, we require pre-payment by the traveler at the time of booking. Net rate content is beneficial for travelers because they can often book travel at a price lower than regularly published offerings. For us, the model generally delivers higher service fee revenue per transaction than comparable transactions under an agency commission booking fee model and we experience improved operating cash flows as a result of receiving pre-payments from customers while paying hotel, car and travel suppliers after the travel occurs. We generally do not purchase and resell travel accommodations and do not have any obligations with respect to travel accommodations listed online that do not sell. For net rate transactions, we recognize as revenue the amount paid by the traveler for products, fees and services minus the amount paid to the travel supplier. See *Risk Factors State and Local Tax Issues* .

Our business strategy depends on net rate bookings as a significant source of future revenue growth and increased margins. Our strategy calls for us to increase or maintain the number of hotel rooms we can market under our net rate hotel program, based upon arrangements we make directly with individual hotel properties and hotel chains. Because of Travelocity s supplier friendly approach, which includes a two-way seamless connectivity to hotels property management system so that reservations are not lost, its hotel program has become successful even though it was started later than some competing programs. One example of the success of this approach was Travelocity s announcement in the third quarter of 2004, that it was the first online intermediary to be certified by InterContinental Hotels Group (IHG) for its more than 3,500 hotels worldwide, including InterContinental Hotels and Resorts, Crowne Plaza, Holiday Inn, Holiday Inn Express, Staybridge Suites and Candlewood Suites. See *Risk Factors Our business plans call for the significant growth of our net rate hotel* .

Cost Reductions and Expense Savings. In the fourth quarter of 2003, we began implementing plans to enhance our competitive position by reducing our operating expenses and better aligning expenses with revenue targets. Through these initiatives, we realized over $80 million in cost savings in 2004. Further, as part of our cost leadership strategy we are, as a standard practice, evaluating efficiency opportunities across the company to ensure that we optimally manage our operational costs. Some of these cost-saving opportunities have involved and may continue to involve globally-sourcing some of our operations (either by contracting with companies that work for us, such as through the opening of call centers we operate abroad, or by expanding our own operations abroad). In the second quarter of 2005 we began implementing an effort to resize and reorganize a development group in our Sabre Travel Network segment. This move will reduce headcount by approximately 120 to 150 employees. These changes are expected to go into effect in August 2005 and to be completed by the end of 2005. As a result of this move, we expect annual cost savings in 2006 and beyond of approximately $13 million to $16 million.

Short and Long-Term Financings. We have funded the acquisition of lastminute.com initially with debt and available cash. We have obtained bridge financing for this acquisition and are considering various long-term financing arrangements, which may or may not include a combination of debt, cash, equity or equity-like securities. See *Management s Discussion and Analysis Liquidity and Capital Resources Financing Arrangements.*

Computer Reservation System Industry Regulation. Aspects of our travel marketing and distribution businesses are subject to the Computer Reservation Systems (CRS) regulations in the European Union, Canada and Peru. These regulations generally govern GDS services for airlines and travel agencies, but not for non-airline suppliers (except rail suppliers in limited circumstances). Among the topics addressed in some of the current regulations are:

- no preferencing CRS displays based upon airline identity,
- equal treatment of airlines by the CRSs,
- equal participation by airlines that have an ownership interest in a CRS, and
- limits on travel agency contract terms.

All CRS regulations promulgated by the U.S. Department of Transportation that were applicable in the United States expired on July 31, 2004. We believe that this deregulation in the United States will enhance our opportunities to creatively market airline services and freely negotiate with travel agencies. However, deregulation also presents challenges associated with maintaining participation levels in the *Sabre* GDS by travel suppliers who are no longer subject to equal participation regulations.

Transport Canada issued final rules on May 7, 2004, eliminating all CRS regulations in Canada, except rules prohibiting screen preference and discrimination in providing the right to participate in service enhancements. In addition, regulators in the European Commission are reviewing their CRS regulations for possible changes, which may include some level of deregulation. It is not clear whether or when any amendments in the European Union will take effect or what form they may take.

The potential effects of these trends, events and uncertainties are discussed below under *Risk Factors*.

Components of Revenues and Expenses

Revenues. Sabre Travel Network primarily generates revenues from transaction fees paid directly to us related to a travel reservation including the following: traditional booking fees paid by travel suppliers, non-traditional transaction fees paid by travel suppliers, transaction fees paid by travel agency subscribers, and transaction fees paid by corporations related to our booking tool. Sabre Travel Network earns revenue through equipment service charges paid by subscribers. In addition, Sabre Travel Network earns revenue through the sale of other products and services (including the *Hotel Spotlight* program, which offers premium marketing opportunities to hoteliers through the *Sabre* GDS, the *Jurni Network* consortia as well as *Nexion*® and *SynXis* offerings to hoteliers) and the *SabreSurround* program (which bundles the *Hotel Spotlight* services with other advertising products) to travel-suppliers, subscribers and other customers. Earnings (or losses as the case may be) derived from interests in joint ventures and other investments are also included in revenues. Sabre Travel Network earns intersegment revenues from data processing fees and transaction fees paid by Travelocity. Travelocity generates revenues from commissions or transaction fees from travel-suppliers for the purchase of travel products and services pursuant to reservations made through our system. Travelocity also generates net rate revenue from providing facilitation services equal to the amount paid by the customer for travel products and services, minus Travelocity s payment to the travel supplier. Additional Travelocity revenues include other fees charged to customers and advertising revenues from our websites. Travelocity derives intersegment revenues from Sabre Travel Network, consisting of incentives earned for Travelocity transactions processed through the *Sabre* GDS, and fees paid by Sabre Travel Network for corporate trips and Sabre Airline Solutions for airline trips booked through Travelocity s online booking technology. Sabre Airline Solutions generates revenues from the sale of airline reservations hosting services, inventory and check-in hosting solutions, decision-support software and technology, and airline consulting services.

Cost of Revenues. Sabre Travel Network cost of revenues consist primarily of customer incentives paid to subscribers, data processing charges resulting from the operation of the *Sabre* system, and salaries and other operating expenses. Sabre Travel Network also incurs intersegment expenses paid to Travelocity for incentives for Travelocity transactions processed through the *Sabre* GDS, as well as fees for corporate trips booked through Travelocity s online booking technology. Travelocity cost of revenues consists primarily of customer service costs, technology costs, salaries, benefits and other employee expenses, data processing fees and transaction fees paid to Sabre Travel Network, credit card fees, charges related to fraudulent bookings and depreciation and amortization charges. Sabre Airline Solutions cost of revenues are comprised of labor cost incurred in the development and delivery of software and consulting services and depreciation and amortization. Sabre Airline Solutions also incurs intersegment expenses paid to Travelocity for airline trips booked through Travelocity s online booking technology.

Operating Expenses. Sabre Travel Network selling, general and administrative expenses and other operating expenses consist of salaries, benefits and employee related expenses for staff functions required to support the business. Travelocity selling, general and administrative and other operating expenses consist primarily of advertising and promotion expenses, payments made to our distribution partners and salaries, benefits and employee related expenses for staff functions required to support the business. Sabre Airline Solutions operating expenses consist of the costs of the sales organization and the staff functions required to support the business.

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Financial Results

The following tables present operating results for the three and six months ended June 30, 2005 and 2004 (in thousands of dollars). The segment revenues and cost of revenues are shown including intersegment activity. We have included the elimination of intersegment activity below in order to agree to the results of operations presented in the consolidated financial statements:

	Three Months Ended June 30,											
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	Sabre Travel Network		Travelocity		Sabre Airline Solutions		Corporate		Eliminations		Total	
Segment revenues:	$ 428,941	$ 407,387	$ 172,064	$ 125,543	$ 66,844	$ 60,511	$	$	$ (48,594)	$ (42,538)	$ 619,255	$ 550,903
Cost of revenues:	294,384	257,131	74,490	49,132	45,476	44,049	(20)	3	(48,594)	(42,538)	365,736	307,777
Gross profit:	134,557	150,256	97,574	76,411	21,368	16,462	20	(3)			253,519	243,126
Selling, general & administrative:	62,968	60,948	91,406	68,086	9,547	10,380	(301)	41			163,620	139,455
Amortization of intangible assets:	4,455	7,349	1,614	7,390	724	489					6,793	15,228
Operating income (loss)	$ 67,134	$ 81,959	$ 4,554	$ 935	$ 11,097	$ 5,593	$ 321	$ (44)	$	$	$ 83,106	$ 88,443

	Six Months Ended June 30,											
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	Sabre Travel Network		Travelocity		Sabre Airline Solutions		Corporate		Eliminations		Total	
Segment revenues:	$ 848,748	$ 818,223	$ 319,141	$ 236,997	$ 129,617	$ 120,247	$	$	$ (96,363)	$ (84,811)	$ 1,201,143	$ 1,090,656
Cost of revenues:	568,354	511,762	144,137	101,557	88,011	91,291	(380)	(507)	(96,363)	(84,811)	703,759	619,292
Gross profit:	280,394	306,461	175,004	135,440	41,606	28,956	380	507			497,384	471,364
Selling, general & administrative:	127,431	132,667	181,071	130,517	19,715	23,005	46	(105)			328,263	286,084
Amortization of intangible assets:	9,750	11,517	3,617	14,852	1,454	980					14,821	27,349
Operating income (loss)	$ 143,213	$ 162,277	$ (9,684)	$ (9,929)	$ 20,437	$ 4,971	$ 334	$ 612	$	$	$ 154,300	$ 157,931

Three Months Ended June 30, 2005 and 2004

Total revenues for the three months ended June 30, 2005 after intercompany eliminations increased approximately $68 million, or 12%, compared to the three months ended June 30, 2004, from $551 million to $619 million. Cost of revenues after intercompany eliminations for the three months ended June 30, 2005 increased approximately $58 million or 19%, compared to the three months ended June 30, 2004, from $308 million to $366 million.

Management s discussion and analysis of revenues, cost of revenues, selling, general and administrative expenses, amortization of intangible assets and operating income by business segment are based upon segment results including intersegment revenues and cost of revenues of approximately $49 million and $43 million for the three months ended June 30, 2005 and 2004, respectively. We account for significant intersegment transactions as if the transactions were to third parties, that is, at estimated current market prices. The majority of the intersegment revenues and cost of revenues are between Travelocity and Sabre Travel Network, consisting mainly of incentives paid to Travelocity for Travelocity transactions processed through the *Sabre* GDS, data processing fees and transaction fees paid by Travelocity to Sabre Travel Network (including for transactions processed through the *Sabre* GDS), and fees paid by Sabre Travel Network to Travelocity for corporate trips booked through Travelocity s online booking technology. In addition, Sabre Airline Solutions pays fees to Travelocity for airline trips booked through Travelocity s online booking technology. All intersegment revenues and corresponding cost of revenues have been eliminated in consolidation.

Total revenues (including intersegment revenues) for the three months ended June 30, 2005 increased approximately $75 million, or 13%, as compared to the three months ended June 30, 2004, from $593 million to $668 million.

Total cost of revenues (including intersegment cost of revenues) for the three months ended June 30, 2005 increased $64 million, or 18%, as compared to the three months ended June 30, 2004, from $350 million to $414 million.

Sabre Travel Network

	Three Months Ended June 30, 2005	2004 (thousands)	change
Segment revenues:	$ 428,941	$ 407,387	$ 21,554
Cost of revenues:	294,384	257,131	37,253
Gross profit:	134,557	150,256	(15,699)
Selling, general & administrative:	62,968	60,948	2,020
Amortization of intangible assets:	4,455	7,349	(2,894)
Operating income	$ 67,134	$ 81,959	$ (14,825)

Revenues

Revenues for the three months ended June 30, 2005 increased $22 million, or 5%, as compared to the three months ended June 30, 2004, from $407 million to $429 million.

Transaction revenue (see *Components of Revenues and Expenses*) increased by $18 million, or 5%. This $18 million increase includes a $21 million increase resulting from higher transaction volumes and a $3 million decrease driven by a lower average rate per transaction, due to growth in lower-priced, non-traditional transactions. Total transactions were 90 million for the three months ended June 30, 2005, an increase of 6% from 85 million transactions in the three months ended June 30, 2004 (see *Business Trends: Changing our Sabre Travel Network Business Model.*)

Subscriber revenue decreased by $5 million, reflecting the trend towards the adoption of third-party equipment solutions by subscribers.

Other revenue increased by $9 million, primarily driven by increased revenue from the *SynXis* reservation management distribution and technology services and various other products. SynXis, which we acquired in January 2005, earned revenues of $5 million in the three months ended June 30, 2005. The *Hotel Spotlight* program, which was not launched until late 2004, contributed $2 million in revenue growth in the three months ended June 30, 2005. The remaining $2 million increase relates to revenue increases associated with various other products.

Cost of Revenues

Cost of revenues for the three months ended June 30, 2005 increased $37 million, or 14%, as compared to the three months ended June 30, 2004, from $257 million to $294 million. The increase in cost of revenues consisted of a $9 million increase in subscriber support costs, a $7 million increase in technology related spending and a $21 million increase in other expenses.

The $9 million increase in subscriber support costs was driven by a $9 million increase in customer incentives. This includes an increase in incentives paid to Travelocity of $2 million resulting from higher transaction volumes. Non-Travelocity incentives grew $6 million as a result of year-over-year growth in the average incentive per transaction driven by competitive pressure on renewals and conversions. Growth in incentives relating to higher bookings volumes grew by $1 million.

Technology related spending increased $7 million due to a $4 million increase over prior year as a result of an expiration of contractual credits and a $3 million increase in our operating costs relating to our phased implementation of our open system pricing and shopping engine.

Other expenses increased $21 million. Headcount related expenses grew $8 million as a result of a $3 million increase in severance related costs, $2 million from growth in new businesses such as SynXis and a $3 million increase in other headcount costs. Spending on internal product development for new pricing, shopping and merchandising functionalities increased $3 million. Fulfillment costs for GetThere corporate trips increased by $2 million as a result of volume growth. Other increases include $2 million related to distribution costs for growing new businesses, $2 million in depreciation related to new product investment, $1 million related to consulting services purchased to assist with development of new businesses, and $3 million in other various expenses.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by $2 million, or 3%, from $61 million for the three months ended June 30, 2004 to $63 million for the three months ended June 30, 2005, primarily driven by a $2 million increase in legal and other professional fees.

Amortization of Intangible Assets

Amortization of intangible assets decreased $3 million, or 43%, from $7 million for the three months ended June 30, 2004 to $4 million for the three months ended June 30, 2005, due primarily to the $3 million write-off of an intangible asset in the second quarter of 2004. Amortization expense from newly acquired entities was offset by intangibles that fully amortized in 2004.

Operating Income

Operating income decreased by $15 million, or 18%, from $82 million for the three months ended June 30, 2004 to $67 million for the three months ended June 30, 2005. The decline in operating income was the result of severance charges incurred this quarter, higher incentives, and investments in emerging businesses such as SynXis that exceeded our revenue growth.

Travelocity

	Three Months Ended June 30, 2005	2004 (thousands)	change
Segment revenues:	$ 172,064	$ 125,543	$ 46,521
Cost of revenues:	74,490	49,132	25,358
Gross profit:	97,574	76,411	21,163
Selling, general & administrative:	91,406	68,086	23,320
Amortization of intangible assets:	1,614	7,390	(5,776)
Operating income	$ 4,554	$ 935	$ 3,619

Revenues

Revenues for the three months ended June 30, 2005 increased $46 million, or 37%, as compared to the three months ended June 30, 2004, from $126 million to $172 million.

In October of 2004, we acquired sole control of the non-German operations of the *Travelocity*® Europe business, purchasing 50% of these entities (the TEU acquisition). The remaining 50% that we already own indirectly through the Travelocity Europe joint venture was distributed to us by the joint venture so that we now directly own 100% of these entities. Since this acquisition, we have been consolidating the results of Travelocity Europe, whereas prior to October 2004, 50% of these results were recorded in other revenues as equity losses.

Transaction revenue, including Travelocity Europe in 2005, increased $40 million, or 37%, primarily driven by a $36 million increase in non-air transaction revenue (including revenue resulting from sales of package offerings that include air travel as a component) and a $4 million increase in stand-alone air transaction revenue.

The $36 million increase in non-air transaction revenue consisted primarily of the following:

Packaged trip revenue increased approximately $20 million due to the growth of our Travelocity *TotalTrip* and Last Minute Deals offerings;

Stand-alone hotel revenue increased $12 million due to the growth of our net rate hotel program;

All other non-air transaction revenue increased $4 million.

The $4 million increase in stand-alone air transaction revenue was primarily due to a volume increase in stand-alone air ticket sales compared to the same period in 2004. Our volume increased due to an overall increase in online travel demand and the TEU acquisition.

Non-transaction revenue increased $6 million, or 38%, consisting primarily of the following:

Joint venture equity method losses, which reduce our revenues, decreased by approximately $5 million. The decreased equity losses resulted from the TEU acquisition;

Corporate revenue, the fees paid by Sabre Travel Network and Sabre Airline Solutions to Travelocity for trips booked through Travelocity s online booking technology, increased by approximately $3 million due primarily to higher booking volumes;

All other non-transaction revenue decreased $2 million.

Cost of Revenues

Cost of revenues for the three months ended June 30, 2005 increased $25 million, or 51%, as compared to the three months ended June 30, 2004, from $49 million to $74 million. The increase was primarily the result of a $9 million increase in expenses associated with the volume growth of our published, net rate hotel, *TotalTrip* and Last Minute Deals programs, as explained above in transaction revenue as well as an increase in service compensation. In addition, this increase includes $8 million from Travelocity Europe and Showtickets.com, which were acquired in the fourth quarter of 2004, and $5 million related to customer service costs as a result of improved transaction volumes. All other expenses increased approximately $3 million.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased approximately $23 million, or 34%, from $68 million for the three months ended June 30, 2004, to $91 million for the three months ended June 30, 2005. This increase includes $12 million from Travelocity Europe and Showtickets.com and $9 million from increased advertising and customer acquisition costs to drive additional travelers to our websites. Other selling, general and administrative expenses increased $2 million.

Amortization of Intangible Assets

Amortization of intangible assets decreased $5 million, or 71%, from $7 million in the three months ended June 30, 2004, to $2 million in the three months ended June 30, 2005, due to certain intangible assets becoming fully amortized in 2004.

Operating income

Operating income increased $4 million, or 400%, from $1 million in the three months ended June 30, 2004, to $5 million in the three months ended June 30, 2005, due to strong revenue growth in our published, *Total Trip*, Last Minute Deals and net rate hotel programs as well as lower intangible amortization costs, which offset the incremental losses resulting from the TEU acquisition.

Sabre Airline Solutions

	Three Months Ended June 30, 2005	2004 (thousands)	change
Segment revenues:	$ 66,844	$ 60,511	$ 6,333
Cost of revenues:	45,476	44,049	1,427
Gross profit:	21,368	16,462	4,906
Selling, general & administrative:	9,547	10,380	(833)
Amortization of intangible assets:	724	489	235
Operating income	$ 11,097	$ 5,593	$ 5,504

Revenues

Revenues increased approximately $6 million, or 10%, from $61 million for the three months ended June 30, 2004 to $67 million for the three months ended June 30, 2005. The increase in revenues was driven primarily by a $4 million increase in airline reservations hosting revenue due to higher transaction volumes from new customers as well as transaction volume growth from our existing customer base. Additionally, product revenue increased $3 million as a result of higher demand for our products and consulting revenue increased $1 million due to certain contractual objectives being met. This growth was offset by a $2 million decline in our low margin, custom developed software business.

Cost of Revenues

Cost of revenues increased approximately $1 million, or 2%, from $44 million for the three months ended June 30, 2004 to $45 million for the three months ended June 30, 2005. This increase is due to a $1 million increase in data processing costs due to transaction volume growth, a $1 million increase in communication costs caused by an increase in data network rates and a $1 million increase in depreciation and amortization due to higher capitalized product labor and capitalized project delivery costs. These increases were offset by a $2 million decrease in headcount related costs due to an increase in capitalized salaries and benefits, a decrease in headcount and a decrease in severance costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased approximately $1 million, or 10%, from $10 million for the three months ended June 30, 2004, to $9 million for the three months ended June 30, 2005. The decrease in selling, general and administrative expenses was driven by a decrease in bad debt expense as a result of receiving payments on accounts that had been previously reserved.

Amortization of Intangible Assets

Amortization of intangible assets increased a nominal amount due to intangible amortization associated with the acquisition of RM Rocade in August 2004.

Operating Income

Operating income increased $5 million, or 83%, from $6 million in the three months ended June 30, 2004, to $11 million in the three months ended June 30, 2005, due primarily to higher revenues.

Operating income increased $5 million, or 83%, from $6 million in the three months ended June 30, 2004, to $11 mi

Interest Income

Interest income for the three months ended June 30, 2005 increased approximately $3 million as compared to the three months ended June 30, 2004. Average balances of our short-term investments were lower, offset by improved rates of return on those balances.

Interest Expense

Interest expense for the three months ended June 30, 2005 increased approximately $2 million as compared to the three months ended June 30, 2004, due to a higher LIBOR rate. A portion of our fixed rate debt is swapped into variable rate debt based on the LIBOR rate. See Note 6 of the Consolidated Financial Statements and *Item 3. Quantitative and Qualitative Disclosures about Market Risk.*

Loss on Derivative Instrument

In order to offset our currency exposure in relation to the acquisition of lastminute.com we purchased an option in May 2005 to acquire GBP and EUR at a fixed rate at or near the closing of the transaction for $10 million. Due to the strengthening of the U.S. Dollar against these currencies, the value of the option has declined to less than $1 million at June 30, 2005, resulting in a $10 million loss.

Other, net

Other, net income for the three months ended June 30, 2005 decreased by $5 million compared to the three months ended June 30, 2004, due to a gain from settling a contract dispute in 2004.

Income Taxes

The provision for income taxes for the three months ended June 30, 2005 decreased by $5 million as compared to the three months ended June 30, 2004. This decrease is due to the tax effect of an approximately $20 million decrease in pre-tax income between periods offset by increased state income tax of $1 million and a reduction of foreign tax credits of $1 million. See Note 5 to the Consolidated Financial Statements for additional information regarding income taxes.

Net Earnings

Net earnings decreased by $15 million during the three months ended June 30, 2005 as compared to the three months ended June 30, 2004. Net earnings was primarily impacted by investments in emerging businesses, hedging activities related to the acquisition of lastminute.com, incentive costs and severance charges.

Six Months Ended June 30, 2005 and 2004

Total revenues for the six months ended June 30, 2005 after intercompany eliminations increased approximately $110 million or 10%, compared to the six months ended June 30, 2004, from $1,091 million to $1,201 million. Cost of revenues after intercompany eliminations for the six months ended June 30, 2005 increased approximately $85 million or 14%, compared to the six months ended June 30, 2004, from $619 million to $704 million.

Management s discussion and analysis of revenues, cost of revenues, selling, general and administrative expenses, amortization of intangible assets and operating income by business segment are based upon segment results including intersegment revenues and cost of revenues of approximately $96 million and $85 million for the six months ended June 30, 2005 and 2004, respectively. We account for significant intersegment transactions as if the transactions were to third parties, that is, at estimated current market prices. The majority of the intersegment revenues and cost of revenues are between Travelocity and Sabre Travel Network, consisting mainly of incentives paid to Travelocity for Travelocity transactions processed through the *Sabre* GDS, data processing fees and transaction fees paid by Travelocity to Sabre Travel Network, and fees paid by Sabre Travel Network to Travelocity for corporate trips booked through Travelocity s online booking technology. In addition, Sabre Airline Solutions pays fees to Travelocity for airline trips booked through Travelocity s online booking technology. All intersegment revenues and corresponding cost of revenues have been eliminated in consolidation.

Total revenues (including intersegment revenues) for the six months ended June 30, 2005 increased approximately $123 million, or 10%, as compared to the six months ended June 30, 2004, from $1,175 million to $1,298 million.

Total cost of revenues (including intersegment cost of revenues) for the six months ended June 30, 2005 increased $96 million, or 14%, as compared to the six months ended June 30, 2004, from $704 million to $800 million.

Sabre Travel Network

	Six Months Ended June 30, 2005	2004 (thousands)	change
Segment revenues:	$ 848,748	$ 818,223	$ 30,525
Cost of revenues:	568,354	511,762	56,592
Gross profit:	280,394	306,461	(26,067)
Selling, general & administrative:	127,431	132,667	(5,236)
Amortization of intangible assets:	9,750	11,517	(1,767)
Operating income	$ 143,213	$ 162,277	$ (19,064)

Revenues

Revenues for the six months ended June 30, 2005 increased $31 million, or 4%, as compared to the six months ended June 30, 2004, from $818 million to $849 million.

Transaction revenue (see *Components of Revenues and Expenses*) increased by $27 million, or 4%. This $27 million increase includes a $29 million increase resulting from increased transaction volumes and a $2 million decrease driven by a lower average net effective rate due to the growth of non-traditional transactions. Total transactions were 182 million for the six months ended June 30, 2005, an increase of 4% from 175 million transactions in the six months ended June 30, 2004 *(see Business Trends: Changing our Sabre Travel Network Business Model.)*

Subscriber revenue decreased by $11 million, reflecting the trend towards the adoption of third-party equipment solutions by subscribers.

Other revenue increased by $15 million, driven by $10 million of SynXis revenue and $4 million of *Hotel Spotlight* revenue, neither of which were a part of the business in 2004. The remaining $1 million increase relates to various other products.

Cost of Revenues

Cost of revenues for the six months ended June 30, 2005 increased $56 million, or 11%, as compared to the six months ended June 30, 2004, from $512 million to $568 million. The increase in cost of revenues consisted of a $16 million increase in subscriber support costs, a $15 million increase in technology related spending and an approximate $25 million increase in other expenses.

The $16 million increase in subscriber support costs includes an $18 million increase in customer incentives. Incentives paid to Travelocity increased $7 million, as a result of higher transaction volumes. Non-Travelocity incentives grew $13 million as a result of growth in the average incentive per transaction. This growth was partially offset by a $2 million decrease in non-Travelocity transaction volumes. The increase in incentive expense was offset by reductions in hardware support and communications costs of $2 million driven by migration to lower cost solutions and the adoption of third-party solutions by subscribers.

Technology related spending increased $15 million due to a $4 million increase related to our continuing expansion of our new functionality and other data processing costs. Operating cost relating to our phased implementation of our open system pricing and shopping engine increased $5 million. Technology costs increased by $6 million as a result of the expiration of contractual credits in the first quarter of 2005.

Other expenses increased approximately $25 million. Headcount related expenses grew $7 million as a result of $3 million from the growth in new businesses, a $3 million increase in severance related costs and $1 million from growth in other headcount costs. Internal product development for new pricing, shopping and merchandizing functionalities increased $4 million. Fulfillment costs for *GetThere* trips increased $4 million as a result of volume growth. Other increases include $4 million in distribution costs for new businesses, $2 million in depreciation related to investment in new products, $1 million in consulting services purchased to assist with development of new businesses, and $3 million in other expenses.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased by $6 million, or 5%, from $133 million for the six months ended June 30, 2004 to $127 million for the six months ended June 30, 2005, primarily driven by a $9 million reduction in tax accruals due to events occurring that decreased our potential liabilities for taxes and associated interest which was partially offset by a $2 million increase in legal and other professional fees and a $1 million increase in other expenses.

Amortization of Intangible Assets

Amortization of intangible assets decreased $2 million, or 17%, from $12 million for the six months ended June 30, 2004 to $10 million for the six months ended June 30, 2005. The decrease in amortization of intangible assets is primarily due to the $3 million write-off of an intangible asset in the second quarter of 2004. In addition, increased amortization expense from newly acquired entities was partially offset by intangibles that fully amortized in 2004 and 2005 resulting in a net increase of $1 million.

Operating Income

Operating income decreased $19 million, or 12%, from $162 million in the six months ended June 30, 2004, to $143 million in the six months ended June 30, 2005, as a result of severance cost incurred in the second quarter of 2005, higher incentives, the loss of contractual credits and investments in new emerging businesses such as SynXis that exceeded our revenue growth.

Travelocity

	Six Months Ended June 30, 2005	2004 (thousands)	change
Segment revenues:	$ 319,141	$ 236,997	$ 82,144
Cost of revenues:	144,137	101,557	42,580
Gross profit:	175,004	135,440	39,564
Selling, general & administrative:	181,071	130,517	50,554
Amortization of intangible assets:	3,617	14,852	(11,235)
Operating loss	$ (9,684)	$ (9,929)	$ 245

Revenues

Revenues for the six months ended June 30, 2005 increased $82 million, or 35%, as compared to the six months ended June 30, 2004, from $237 million to $319 million.

In October of 2004, we acquired sole control of the non-German operations of Travelocity Europe, purchasing 50% of these entities (the TEU acquisition). The remaining 50% that we did already own indirectly through the Travelocity Europe joint venture was distributed to us by the joint venture so that we now directly own 100% of these entities. Since this acquisition, we have been consolidating the results of Travelocity Europe, whereas prior to October 2004, 50% of these results were recorded in other revenues as equity losses.

Transaction revenue, including Travelocity Europe, in 2005 increased $69 million, or 34%, primarily driven by a $60 million increase in non-air transaction revenue (including revenue resulting from sales of package offerings that include air travel as a component) and a $9 million increase in stand-alone air transaction revenue.

The $60 million increase in non-air transaction revenue consisted primarily of the following:

Packaged trip revenue increased approximately $36 million due to the growth of our Travelocity *TotalTrip* and Last Minute Deals offerings;

Stand-alone hotel revenue increased $20 million due to the growth of our net rate hotel program;

All other non-air transaction revenue increased $4 million.

The $9 million increase in stand-alone air transaction revenue was primarily due to a volume increase in stand-alone air ticket sales compared to the same period in 2004. Our volume increased due to an overall increase in online travel demand and the TEU acquisition.

Non-transaction revenue increased $13 million, or 38%, consisting primarily of the following:

Joint venture equity method losses, which reduce our revenues, decreased by approximately $7 million. The decreased equity losses resulted from the TEU acquisition;

Corporate revenue, the fees paid by Sabre Travel Network and Sabre Airline Solutions to Travelocity for trips booked through Travelocity s online booking technology, increased by approximately $5 million due primarily to higher booking volumes;

All other non-transaction revenue increased $1 million.

Cost of Revenues

Cost of revenues for the six months ended June 30, 2005 increased $42 million, or 41%, as compared to the six months ended June 30, 2004, from $102 million to $144 million. The increase in cost of revenues in the six months ended June 30, 2005 compared with the six months ended June 30, 2004 was primarily the result of a $16 million increase in expenses associated with the volume growth of our published, net rate hotel, *TotalTrip* and Last Minute Deals programs, as explained above in transaction revenue as well as an increase in service compensation. In addition, this increase includes $14 million from Travelocity Europe and Showtickets.com, which were acquired in the fourth quarter of 2004, and $10 million related to customer service costs as a result of improved transaction volumes. All other expenses increased approximately $2 million.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased approximately $50 million, or 38%, from $131 million for the six months ended June 30, 2004 to $181 million for the six months ended June 30, 2005. This increase includes $28 million from Travelocity Europe and Showtickets.com and $21 million due to increased advertising and customer acquisition costs to drive additional travelers to our websites. The increase in advertising expense includes changes in the timing of recognizing advertising expenses within the fiscal year which resulted in a $6 million increase in advertising expenses (See Note 2 to the Consolidated Financial Statements). Other selling, general and administrative expenses increased $1 million.

Amortization of Intangible Assets

Amortization of intangible assets decreased $11 million, or 73%, from $15 million in the six months ended June 30, 2004 to $4 million in the six months ended June 30, 2005, due to certain intangible assets becoming fully amortized in 2004.

Operating Loss

Operating loss for the six months ended June 30, 2005 was unchanged compared with the six months ended June 30, 2004, due to higher revenue growth and lower intangible amortization offset by higher incremental cost resulting from the TEU acquisition and an increase in advertising expenses.

Sabre Airline Solutions

	Six Months Ended June 30, 2005		2004 (thousands)		change	
Segment revenues:	$	129,617	$	120,247	$	9,370
Cost of revenues:		88,011		91,291		(3,280)
Gross profit:		41,606		28,956		12,650
Selling, general & administrative:		19,715		23,005		(3,290)
Amortization of intangible assets:		1,454		980		474
Operating income	$	20,437	$	4,971	$	15,466

Revenues

Revenues increased approximately $10 million, or 8%, from $120 million for the six months ended June 30, 2004 to $130 million for the six months ended June 30, 2005. The increase in revenues was driven primarily by a $7 million increase in product revenue as a result of higher demand for our products. Additionally, airline reservations hosting revenue increased $6 million due to higher transaction volumes from new customers as well as transaction volume growth from our existing customer base. Consulting revenues increased $2 million due to certain contractual objectives being met. This growth was offset by a $5 million decline in our low margin, custom developed software business.

Cost of Revenues

Cost of revenues decreased approximately $3 million, or 3%, from $91 million for the six months ended June 30, 2004 to $88 million for the six months ended June 30, 2005. This decrease is due to an $8 million decrease in headcount related expenses driven by an increase in capitalized salary and benefits and a decrease in headcount. This decrease is offset by a $1 million increase in data processing cost primarily due to transaction volume growth, a $1 million increase in depreciation and amortization due to an increase in capitalized product labor and capitalized project delivery costs, a $1 million increase in services purchased due primarily to the outsourcing of training and other services and a $2 million increase in other expenses.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased approximately $3 million, or 13%, from $23 million for the six months ended June 30, 2004 to $20 million for the six months ended June 30, 2005. This decrease in selling, general and administrative expenses was driven by a $5 million decrease in bad debt expense caused by the receipt of payments on accounts that had been previously reserved. This decrease was somewhat offset by increases in other expenses of $2 million.

Amortization of Intangible Assets

Amortization of intangible assets increased a nominal amount due to intangible amortization associated with the acquisition of RM Rocade in August 2004.

Operating Income

Operating income increased $15 million, or 300%, from $5 million in the six months ended June 30, 2004, to $20 million in the six months ended June 30, 2005. The increase in operating income was primarily driven by higher revenues, cost savings in headcount related expenses and more favorable collection activities.

Operating income increased $15 million, or 300%, from $5 million in the six months ended June 30, 2004, to $20 m

Operating income increased $15 million, or 300%, from $5 million in the six months ended June 30, 2004, to $20 m

Interest Income

Interest income for the six months ended June 30, 2005 increased by $4 million as compared to the six months ended June 30, 2004. Average balances of our short-term investments were lower, offset by improved rates of return on those balances.

Interest Expense

Interest expense for the six months ended June 30, 2005 increased approximately $3 million as compared to the six months ended June 30, 2004 due to a higher LIBOR rate. A portion of our fixed rate debt is swapped into variable rate debt based on the LIBOR rate. See Note 6 of the Consolidated Financial Statements and *Item 3. Quantitative and Qualitative Disclosures about Market Risk.*

Gain on Sale of Investment

On March 11, 2005, we sold our interest in Karavel SA, a French tour operator, to Opodo Limited. We received approximately $26 million (Euro 20 million) in cash proceeds in connection with the sale and recorded a $21 million gain in other income.

Loss on Derivative Instrument

In order to offset our currency exposure in relation to the acquisition of lastminute.com we purchased an option in May 2005 to acquire GBP and EUR at a fixed rate at or near the closing of the transaction for $10 million. Due to the strengthening of the U.S. Dollar against these currencies, the value of the option declined to less than $1 million at June 30, 2005 resulting in a $10 million loss.

Other, net

Other, net income for the six months ended June 30, 2005 decreased by $5 million compared to the six months ended June 30, 2004, due to a gain from settling a contract dispute in 2004.

Income Taxes

The provision for income taxes for the six months ended June 30, 2005 increased $3 million as compared to the six months ended June 30, 2004. This increase is due to the tax effect of an approximately $3 million increase in pre-tax income between periods, an increase in state taxes of $1 million, and a reduction of foreign tax credits of $1 million. See Note 5 to the Consolidated Financial Statements for additional information regarding income taxes.

Net Earnings

Net earnings for the six months ended June 30, 2005 was unchanged as compared to the six months ended June 30, 2004. During this period we experienced revenue growth and realized a gain from the sale of an investment, however, these gains to net earnings were offset by investments in emerging businesses, hedging activities related to the acquisition of lastminute.com, incentive costs and severance charges.

SABRE HOLDINGS CORPORATION

LIQUIDITY AND CAPITAL RESOURCES

We require cash to pay our operating expenses, make capital expenditures, invest in our products and offerings, pay dividends, repurchase shares of our Common Stock and service our debt and other long-term liabilities. Although our primary source of funds has been from our operations, we have in the past and may in the future raise external funds through the sale of stock or debt in the public capital markets or in privately negotiated transactions. In assessing our liquidity, key components include our net income adjusted for non-cash and non-operating items, and current assets and liabilities, in particular accounts receivable, accounts payable, and accrued expenses. For the longer term, our debt and long-term liabilities are also considered key to assessing our liquidity.

Our current cash flows from operations, existing balances in cash and short-term investments and funds available under our revolving credit facility and our Bridge Facility for the lastminute.com acquisition are sufficient to fund our planned expenditures which include operating expenses, capital expenditures, investments in our products and offerings, interest payments on our debt and dividends. We may also consider using our funds available or possibly external sources of funds for acquisitions of, or investments in, complementary businesses, products, services and technologies when such opportunities become available. These types of additional activities might affect our liquidity requirements or cause us to issue additional equity or debt securities.

In the long-term, we expect to use our existing funds and cash flows from operations to satisfy our debt and other long-term obligations. We may also use our funds, as well as external sources of funds, to retire debt as appropriate, based upon market conditions and our desired liquidity and capital structure.

Risk factors that could possibly affect the availability of our internally generated funds include, among other things:

margin pressure from increased customer incentives in our Sabre Travel Network business,

changes in our Sabre Travel Network business model, including new pricing options offered to travel suppliers upon expiration of the DCA 3-Year Option agreements;

diversion of transactions away from our channel offerings and other competitive pressures, and

increased spending to fund growth in Travelocity and the integration of lastminute.com.

See *Risk Factors* for a more complete discussion of risk factors that might affect the availability of our internally generated funds.

As a result of the additional debt we incurred on August 1, 2005 to fund the acquisition of lastminute.com, Standard & Poor s changed our credit rating from BBB+ to BBB. That is still an investment grade credit rating and is not anticipated to have a material impact on our borrowing cost.

Moody s Investors Service is still evaluating a potential change in our current credit rating of Baa2, which is also investment grade.

Cash Investments

We invest cash in highly liquid instruments, including high credit quality money market mutual funds, certificates of deposit, banker s acceptances, commercial paper, repurchase agreements, mortgage-backed and receivables-backed securities and corporate and government notes, including tax-exempt municipal securities. We try to invest all of our excess cash in marketable securities. Therefore, our annual investments will fluctuate depending on the levels of cash provided or used by all of our other investing, operating and financing activities.

Capital Activities

Dividends. On January 20, 2004, we announced a dividend of $.075 per share. We paid dividends of that same amount in all quarters of 2004. On February 1, 2005, we announced a dividend of $.09 per share which was paid on February 28, 2005 to stockholders of record at February 11, 2005. On May 3, 2005, we announced a dividend of $.09 per share which was paid on May 26, 2005 to stockholders of record at May 13, 2005. On July 26, 2005, we announced a dividend of $.09 per share payable on August 18, 2005 to stockholders of record at August 5, 2005. Based on a quarterly dividend of $.09 per share, and assuming that the current number of outstanding shares of our Common Stock remains constant for the remainder of 2005, we expect to pay an aggregate of approximately $45 to $50 million in dividends during the fiscal year 2005. Our Board of Directors currently intends to consider declaring and paying comparable future dividends on a regular quarterly basis, subject to our ability to pay dividends and to a determination by management and our Board of Directors that dividends continue to be in our best interests and those of our stockholders.

Repurchases of Stock. On October 20, 2003, our Board of Directors approved a share repurchase program authorizing us to repurchase up to $100 million of our Common Stock. At December 31, 2003, we had remaining authorization to repurchase approximately $72 million of our Common Stock under this program. During the three months ended March 31, 2004, we repurchased 3,336,862 shares of our Common Stock for approximately $72 million, thereby completing the remaining authorization to repurchase shares under that program. On April 19, 2004, our Board of Directors approved another share repurchase program authorizing us to repurchase up to an additional $100 million of our Common Stock. We repurchased 4,038,166 shares of our Common Stock under this authorization. This authorization was completed on November 1, 2004. On October 25, 2004, our Board of Directors approved another share repurchase program authorizing us to repurchase up to an additional $100 million of our Common Stock. At December 31, 2004, we had repurchased 2,516,284 shares of our Common Stock and had remaining authorization to repurchase approximately $43 million of our Common Stock under this program. During the first quarter of 2005, we repurchased 2,042,063 shares of our Common Stock, completing this authorization on March 14, 2005.

On May 2, 2005, we received authorization from the Board of Directors to repurchase an additional $100 million of our Common Stock. Due to the acquisition of lastminute.com, no purchases of our Common Stock have been made under this authorization as of the date of this report. As in the past, implementation of the program is at management s discretion and will depend on the best uses for our available cash.

In addition, on October 20, 2003, our Board of Directors authorized the purchase of shares of our Common Stock to satisfy our obligations to deliver shares under our Employee Stock Purchase Plan and our Long-Term Incentive Plan. We did not repurchase any shares of our Common Stock under this program during 2004. We purchased 840,000 shares under this authorization in January 2005.

We will generally seek to make any future share repurchases pursuant to 10b5-1 trading plans, unless such plans are terminated at the discretion of management.

Financing Arrangements

Bridge Financing Arrangement

On May 12, 2005, we entered into an $800 million, unsecured, multi-draw bridge loan agreement (the Bridge Facility) that matures on August 12, 2006, in order to provide temporary financing in connection with the lastminute.com acquisition of all of the shares of lastminute.com and to satisfy legal requirements for certainty of funding for the lastminute.com acquisition. On July 22, 2005, we entered into an amendment to the Bridge Facility whereby all the rights and obligations of Sabre Inc. under the Bridge Facility were assumed by Sabre Holdings and Sabre Inc. was discharged from its obligations thereunder.

Effective August 1, 2005, we borrowed $800 million under the Bridge Facility in order to partially finance the purchase of the shares of lastminute.com in connection with the lastminute.com acquisition.

The interest rate on borrowings under the Bridge Facility is variable, based at our discretion on either the London Interbank Offered Rate (LIBOR) plus a borrowing spread or the prime rate, and is sensitive to our credit rating. The LIBOR based interest rate at our current credit rating is equal to approximately 4%. The Bridge Facility requires us to pay, quarterly and upon termination of the Bridge Facility, a commitment fee based on the preceding quarter s unused portion of the Bridge Facility multiplied by a commitment fee percentage specified in the Bridge Facility. We are also required to pay other fees based on the Bridge Facility amount. These fees are not material.

We may prepay all or any part of the Bridge Facility without prepayment penalty, other than any breakage costs associated with the early repayment of loans bearing interest based upon LIBOR. We would be required to repay borrowings under the Bridge Facility with net cash proceeds we receive from (i) the issuance of capital stock and indebtedness for money borrowed with a maturity in excess of one year (excluding, among other things, borrowings under our existing revolving credit agreement) and (ii) asset sales with a value of more than $200 million.

The Bridge Facility contains other covenants, representations, terms and conditions that are typical for a bridge credit facility of this type which, among other things, restricts our ability to incur additional debt and limits our ability to pay in excess of $150 million during the term of the Bridge Facility as dividends or to repurchase our stock.

As of June 30, 2005, we are in compliance with all covenants under the Bridge Facility including the following financial covenants:

Covenant		Requirement		Level at June 30, 2005
Consolidated Leverage Ratio (Debt to EBITDA)		5.0 to 1 maximum		1.4 to 1
Consolidated Net Worth	$	1.252 billion	$	1.6 billion

On August 1, 2005, we used approximately $359 million in cash ($234 million, net of cash acquired) and incurred approximately $800 million in additional indebtedness. Although this materially increases our Consolidated Leverage Ratio, we believe we continue to be in compliance with the financial and other covenants under the Bridge Facility.

Revolving Credit Facility.

On July 22, 2005, in order to facilitate the consummation of the lastminute.com acquisition and to provide additional liquidity and flexibility in our capital structure, we entered into certain amendments to our existing $300 million revolving credit agreement (the Revolver) with Bank of America, N.A., as agent. Under the amendments, Sabre Holdings assumed all of the rights and obligations of Sabre Inc. under the Revolver and Sabre Inc. was discharged from its obligations thereunder. The amendments also include, among other things: (i) amendments to certain financial and negative covenants (including amendments to provide us more flexibility under the Consolidated Leverage Ratio covenant and amendments that place additional restrictions on our subsidiaries ability to incur indebtedness), (ii) amendments that prohibit us from using proceeds from the Revolver to repay the Bridge Facility to the extent such proceeds represent more than 50% of the then aggregate committed amount of the lenders under the Revolver, (iii) amendments that increase the aggregate amount committed by those lenders to $360 million, and (iv) amendments that allow us to request a future increase of the aggregate amount committed by the lenders under the Revolver to as much as $500 million.

As of June 30, 2005, we were in compliance with all covenants under the Revolver including:

Prior to amendment dated July 22, 2005	**Requirement**	**Level at June 30, 2005**
Consolidated Leverage Ratio (Debt to EBITDA)	3 to 1 maximum	1.4 to 1
Consolidated Net Worth	$ 1.252 billion	$ 1.6 billion

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Our covenants under the amended revolving credit agreement are as follows:

As amended on July 22, 2005	Requirement
Consolidated Leverage Ratio (Debt to EBITDA):	
July 22, 2005 through March 30, 2006	3.75 to 1 maximum
June 30, 2006 through September 30, 2006	3.50 to 1 maximum
December 31, 2006 through March 31, 2007	3.25 to 1 maximum
June 30, 2007 and thereafter	3.00 to 1 maximum

In order to fund amounts due in connection with completing the lastminute.com acquisition, we used approximately $359 million in cash ($234 million, net of cash acquired) and incurred approximately $800 million in additional indebtedness. Although this materially increases our Consolidated Leverage Ratio, we believe we continue to be in compliance with the financial and other covenants under the Revolver.

Public Notes. In August 2001, we issued through Sabre Holdings Corporation $400 million in unsecured notes (Notes), bearing interest at 7.35% and maturing August 1, 2011, in an underwritten public offering resulting in net cash proceeds to us of approximately $397 million. The Notes include certain non-financial covenants, including restrictions on incurring certain types of debt or entering into certain sale and leaseback transactions. As of June 30, 2005, we are in compliance with all covenant requirements under the Notes. Sabre Inc., a 100% owned subsidiary of Sabre Holdings Corporation, unconditionally guarantees all debt obligations of Sabre Holdings Corporation. In conjunction with these Notes, we have entered into two interest rate swaps through 2011 for a total of $300 million, which pay us 7.35% and on which we pay a variable rate based on a six-month LIBOR plus 231 basis points.

Capital Lease Obligation. In June 2003, we entered into a ten-year master lease for our corporate headquarters facility in Southlake, Texas, which is accounted for as a capital lease. The interest rate on the capital lease financing is fixed at 5.37%. At the inception of the lease, we recorded an asset of approximately $168 million, along with a liability of approximately $168 million, representing the present value of the minimum lease payments due under the lease and the residual value guarantee discussed below.

At any time during the lease term, we have the option to terminate the lease and purchase the properties for approximately $179 million, plus a make-whole amount, if applicable. We also have the option at any time up to one year prior to lease expiration to cause the properties to be sold. If this sell option is exercised, we have guaranteed that proceeds on a sale will be at least approximately $159 million, and we are responsible for the first dollar loss up to approximately $159 million due to a decrease in the value of the property below approximately $179 million. If the sales proceeds exceed approximately $179 million plus any sales-related expenses, we retain the excess. In conjunction with this lease, we have entered into a $100 million interest rate swap which pays us 5.37% and on which we pay a variable rate based on a six-month LIBOR plus 153 basis points. Under the lease agreement, we are subject to certain covenants. As of June 30, 2005, we are in compliance with all covenants under this agreement including the following financial covenant:

	Requirement	Level at June 30, 2005
Consolidated Net Worth	$ 1.0 billion	$ 1.6 billion

Off-Balance Sheet Arrangements

We do not have any relationships or agreements as of June 30, 2005 that would be considered an off balance sheet arrangement as defined by Item 303(a)4ii of Regulation S-K.

Cash Flows (in thousands)

	Six Months Ended June 30, 2005		2004	
Cash provided by operating activities	$	154,375	$	286,351
Cash used for investing activities	$	(72,510)	$	(181,770)
Cash used for financing activities	$	(84,109)	$	(113,741)

Operating Activities. Cash provided by operating activities during the six months ended June 30, 2005 was $154 million, which was primarily from net earnings of $102 million adjusted for non-cash and non-operating items. Cash provided by working capital items was less than $1 million, which includes accounts receivable, prepaid expenses, accrued compensation and benefits, accounts payable and other accrued liabilities. Non-cash adjustments are an increase to net earnings of $52 million for the six months ended June 30, 2005 and included depreciation and amortization of $53 million, equity losses of $3 million in joint ventures, a loss on a foreign currency option of $10 million, deferred income taxes of $3 million and stock compensation expense of $6 million offset by a gain on the sale of our investment in Karavel of $21 million and other non-cash adjustments of $2 million.

Cash provided by operating activities during the six months ended June 30, 2004 was $286 million, which was primarily from net earnings of $102 million adjusted for non-cash and non-operating items and cash provided by working capital items totaling $104 million, which includes accounts receivable, prepaid expenses, accrued compensation and benefits, accounts payable and other accrued liabilities. Non-cash adjustments to net earnings of $81 million for the first half of 2004 included depreciation and amortization of $64 million, equity losses of $8 million in joint ventures, $10 million in allowances for doubtful accounts and stock compensation expense of $6 million offset by $3 million in deferred taxes and $4 million in other non-cash adjustments.

Cash provided by operating activities decreased by $132 million in the six months ended June 30, 2005 as compared to the year-ago period. This decrease in cash provided by operating activities was partially due to a decrease in net income adjusted for non-cash adjustments of $29 million. Additionally, cash provided by working capital decreased by $103 million. Although working capital was positively impacted by the increased use of our net rate program, several factors contributed to offset this, including: a higher payout of incentive compensation, a one time receipt of $20 million in 2004 from contracts cancelled in 2003, timing of payments to our net rate program suppliers, payment of incentives in the second quarter of 2005 that were not paid until the third quarter in 2004, timing of tax payments and an increase in our accounts receivable balances from higher bookings and from entities acquired in the last half of 2004 and 2005.

Investing Activities. The $109 million decrease in cash used for investing activities in the six months ended June 30, 2005 as compared to the year-ago period primarily results from a $139 million increase in net sales of our portfolio of marketable securities. Also contributing to the decrease, was the $26 million of proceeds from the sale of our investment in Karavel. Offsetting these proceeds from investing activities were $67 million of cash expenditures for acquisitions and $13 million in loans and investments to joint ventures in the first half of 2005 compared to $33 million of such expenditures in the same period a year ago. Additionally, in the first half of 2005, we had $5 million more in capital expenditures and spent $10 million to purchase a foreign currency option.

Financing Activities. Cash used for financing activities decreased $30 million for the six months ended June 30, 2005 as compared to the same period a year ago. This decrease was primarily due to a reduction in the number of shares of our Common Stock that we repurchased under our Board authorized stock repurchasing plans resulting in a $39 million reduction in cash outflows. Offsetting this decrease in shares of Common Stock repurchased was an increase in dividends paid of $3 million due to an increase in our dividend rate from $.075 per share in 2004 to $.09 per share in 2005. Proceeds from the issuance of Common Stock decreased $7 million due to fewer employee stock option excercises resulting from a generally lower price of our Common Stock.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect our reported assets and liabilities, revenues and expenses, and other financial information. Actual results may differ significantly from these estimates, and our reported financial condition and results of operations could vary under different assumptions and conditions. In addition, our reported financial condition and results of operations could vary due to a change in the application of a particular accounting standard.

We regard an accounting estimate underlying our financial statements as a critical accounting estimate if the accounting estimate requires us to make assumptions about matters that are highly uncertain at the time of estimation and if different estimates that reasonably could have been used in the current period, or changes in the estimate that are reasonably likely to occur from period to period, would have had a material effect on the presentation of financial condition, changes in financial condition, or results of operations.

There have been no changes to our critical accounting policies or significant changes in assumptions or estimates that would affect such policies in the three months ended June 30, 2005. Our critical accounting policies are described under the caption *Management s Discussion and Analysis of Financial Condition and Results of Operations* in our Annual Report on Form 10-K. In addition, for a discussion of significant accounting policies, see Footnote 2 of our audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2004, as well as Footnote 2 to our unaudited interim financial statements included in this Quarterly Report on Form 10-Q.

Advertising Prior to 2005, certain advertising costs were deferred within the fiscal year to future interim periods where the benefit of that advertising extended beyond the quarter in which they occurred. Beginning in 2005 and all subsequent interim periods, advertising costs are expensed as incurred with no deferral within the fiscal year. Our current advertising strategy is to generate immediate interest in travel promotions and products where returns are more immediate than in the past when our strategy was developing overall brand awareness.

This timing change resulted in lower selling, general and administrative expenses for the three months ended June 30, 2005 of an estimated $2 million and higher net income of $1 million or $.01 per share. For the six months ended June 30, 2005, this timing change resulted in higher selling, general and administrative expenses of an estimated $6 million and lower net income of $4 million or $.03 per share. Due to this timing change, we expect to recognize lower advertising expenses in subsequent quarters of 2005 than in the comparable periods of the prior year, offset by any increases in advertising volume.

Had we employed the revised methodology in 2004, selling, general and administrative expenses would have been an estimated $2 million higher and net income an estimated $1 million, or $.01 per share lower for the three months ended June 30, 2004. For the six months ended June 30, 2004, selling, general and administrative expenses would have been an estimated $14 million higher and net income an estimated $9 million, or $.07 per share lower under the revised methodology.

SABRE HOLDINGS CORPORATION

CAUTIONARY STATEMENT

Statements in this report which are not purely historical facts or which necessarily depend upon future events, including statements regarding our anticipations, beliefs, expectations, hopes, intentions or strategies for the future, may be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. All forward-looking statements in this report are based upon information available to us on the date of this report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Any forward-looking statements made in this report involve risks and uncertainties that could cause actual events or results to differ materially from the events or results described in the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements. In addition, oral statements made by our directors, officers and employees to the investor and analyst communities, media representatives and others, depending upon their nature, may also constitute forward-looking statements. As with the forward-looking statements included in this report, these forward-looking statements are by nature inherently uncertain, and actual results may differ materially as a result of many factors including, but not limited to, those discussed below.

RISK FACTORS

Risks associated with an investment in our securities, and with achieving the forward-looking statements contained in this report or in our news releases, websites, public filings, investor and analyst conferences or elsewhere, include, but are not limited to, the risk factors described below. Any of the risk factors described below could have a material adverse effect on our business, financial condition or results of operations. We may not succeed in addressing these challenges and risks.

Our revenues are highly dependent on the travel and transportation industries, and particularly on airlines, and a prolonged substantial decrease in travel transaction volumes could adversely affect us.

Most of our revenue is derived from airlines, hotel operators, car rental companies, cruise operators and other suppliers in the travel and transportation industries. Our revenue increases and decreases with the level of travel and transportation activity and is therefore highly subject to declines in or disruptions to travel and transportation due to factors entirely out of our control. The travel industry is seasonal and our revenue varies significantly from quarter to quarter. Factors that may adversely affect travel and transportation activity include:

- economic downturns and recessions,
- global security issues, political instability, acts of terrorism, hostilities and war,
- increased airport security that could reduce the convenience of air travel,
- inclement weather,
- increased occurrence of travel-related accidents,
- travelers concerns about exposure to contagious diseases such as SARS or avian bird flu,
- economic and political issues in the Middle East and elsewhere, and
- the financial condition of travel suppliers.

The possibility of further terrorist attacks, hostilities and war, the resulting security measures at airports, and the financial instability of many of the air carriers may continue to adversely affect the travel industry. Airlines may reduce the number of their flights, making fewer offerings available to us. We depend on a relatively small number of airlines for a significant portion of our revenues. Several major airlines are experiencing liquidity problems, some (including U.S. Airways Group, Inc. and America West Holdings Corp.) are pursuing consolidation, some (including United Airlines, Inc., U.S. Airways Group, Inc. and ATA Holdings Corporation) have sought bankruptcy protection and still others may consider bankruptcy relief. Travelers perceptions of passenger security or airlines financial stability may have an adverse effect on demand. The financial instability of airlines or a prolonged substantial decrease in travel transaction volumes could have an adverse impact on our financial performance, operations, liquidity, or capital resources and could impair our ability to recover the carrying value of certain of our assets, including capitalized software, other intangible assets and goodwill.

We will also encounter risks and difficulties frequently experienced in rapidly evolving industries such as the travel industry, and particularly the online travel industry. Some of these risks relate to our ability to:

attract and retain customers on a cost-effective basis,

expand and enhance our service offerings,

operate, support, expand and develop our operations, our websites, our software and our communications and other systems,

maintain and diversify our sources of revenue, including by entering into agreements that may reflect changes to our *Sabre* GDS business model,

maintain and develop our existing brands and distribution channels, as well as to make cost-effective expenditures in connection with these initiatives,

manage our relationships with important travel suppliers and other industry participants,

manage litigation, including our current litigation with Northwest, and

respond to competitive marketplace conditions.

If we are unsuccessful in addressing these risks or in executing our business strategy, our business, financial condition or results of operations may suffer.

We face competition from established and emerging travel distribution channels, risks related to deregulation of the CRS industry and possible internal channel conflict, which could divert customers to our competitors and adversely affect our results of operations.

Our business includes channels of distribution that support the travel agency, business-direct and consumer-direct segments of the global travel distribution marketplace. In all of these distribution channels, we face significant competition. In the travel agency channel, our *Sabre* GDS competes primarily against other large and well-established global distribution systems, but new GDS alternatives and limited travel distributors, or LTDs. , are also being promoted in the marketplace. With the deregulation of the CRS industry in the United States, our CRS business will be competing in a free-market system. Our current and potential customers may elect to use a competing GDS or an LTD offering lower prices. Furthermore, one or more airlines may elect to discontinue or to lower their levels of participation in the *Sabre* GDS. Losing access to inventory from one or more major suppliers would make the *Sabre* GDS less attractive to travel agencies and travel purchasers, which could reduce our transaction fee revenue. In order to gain access to suppliers inventory (including suppliers for whom DCA 3-Year Option contracts will be expiring in 2005 and 2006), it might become necessary for us to reduce further the fees charged to suppliers, which could reduce our transaction fee revenue without a corresponding reduction in costs. In addition, we face increasing competition in the travel agency channel from travel suppliers that distribute directly to travel agencies as well as to consumers.

In the business-direct channel, both the *Travelocity Business* and Sabre Travel Network *GetThere* products compete against similar offerings from other travel agencies. Some competitors market business travel systems that are bundled with financial and other non-travel software systems that we do not offer. As a result, our current and potential customers may choose the convenience or cost-effectiveness of our competitors bundled products and services, which may increase the pricing pressure on our offerings.

In the consumer-direct channel, our Travelocity offering competes not only against similar offerings from affiliates of other global distribution systems, but also with travel suppliers, online vertical search engines, and a large number of online travel agencies.

Our Sabre Airline Solutions business unit competes against several organizations offering internal reservation system and related technology services to airlines. This segment is highly competitive. If we cannot compete effectively to keep and grow this segment of business, we risk losing customers and economies of scale, which could have a negative impact on our operating results.

We expect existing competitors, business partners and new entrants to the travel business to constantly revise and improve their business models in response to challenges from competing businesses, including ours. If these or other travel industry participants introduce changes or developments that we cannot meet in a timely or cost-effective manner, our business may be adversely affected. In addition, consumers frequently use our websites for route pricing and other travel information, and then choose to purchase travel offerings from a source other than our website, including travel suppliers own websites. Such use may increase our costs without producing revenue.

In addition, consolidation among our competitors may give our competitors increased negotiating leverage with travel suppliers and greater marketing resources, thereby providing corresponding competitive advantages over us. Consolidation among travel suppliers, including airline mergers, may increase competition from distribution channels related to those suppliers and place more leverage in the hands of those suppliers to negotiate lower transaction fees. Consolidation among travel agencies could increase this leverage over Sabre Travel Network in negotiating contract terms, such as customer incentives payable by Sabre Travel Network. If we are unable to compete effectively, competitors could divert our customers away from our travel distribution channels and adversely affect our results of operations.

In certain limited circumstances, our business segments may conflict with each other. For example, both our *Travelocity.com*® and *Travelocity Business* websites may compete with the travel-agency subscribers of Sabre Travel Network. Although we believe that our participation in both the traveler-direct and distribution intermediary businesses is a distinct advantage for Sabre Holdings due to synergies including greater scale of our technology, conflicts with customers of our different businesses could adversely affect our results of operations. For example, such conflict could cause some of our current or potential travel agency customers to consider competing GDS providers (or online websites) or other direct or indirect channels of travel distribution.

Some travel suppliers are seeking alternative distribution models, and alternative models of travel distribution are emerging, which may adversely affect our results of operations.

Some travel suppliers are seeking to decrease their reliance on distribution intermediaries, including global distribution systems such as our *Sabre* GDS. Travel suppliers may give advantages to distribution intermediaries in which they have an economic stake or may create or expand commercial relationships with online and traditional travel agencies that work with travel suppliers to directly book travel with those suppliers. Many airlines, hotels, car rental companies and cruise operators have established their own travel distribution websites. Several suppliers have formed joint ventures that offer multi-supplier travel distribution websites. From time to time, travel suppliers offer advantages, such as bonus miles, lower transaction fees, or discounted prices, when their products and services are purchased from these supplier-related websites. Some of these offerings are not available to unrelated intermediaries, or those intermediaries must accept lower transaction fees in exchange for access to the offerings. In addition, the airline industry has experienced a shift in segment share from full-service carriers to low-price carriers. Some low-cost carriers do not distribute their tickets through the *Sabre* GDS or through other third-party intermediaries. In addition, established search engine companies as well as start ups are attempting to enter the online travel marketplace by leveraging search technology to aggregate travel search results across supplier, travel agent and other travel-related websites. These search engines and alternative travel distribution channels have the potential to divert customers from our online sites and our *Sabre* GDS. These developments put pressure on our revenues, pricing and operating margins. See *Business Trends - Supplier Efforts to Control Travel Distribution* and *Business Trends Competition and Consolidation.*

Adverse changes in or interruptions to our relationships with travel suppliers could affect our access to travel offerings and reduce our revenues.

We rely on participating carrier agreements, such as our DCA 3-Year Option, with our airline suppliers, and these agreements contain terms that reduce our revenues by providing discounted pricing. None of these arrangements is exclusive and airline suppliers could enter into, and in some cases may have entered into, similar agreements with our competitors. In addition, most of the agreements we have with airline suppliers will expire by their terms within the next year unless they are extended or replaced. The new agreements we are executing and expect to execute with airline suppliers may have substantially different pricing and/or operational structures than our DCA 3-Year Option agreements. In some cases we may approach airlines with pricing options from any combination of our business units. These and other new business models we are exploring for our Sabre Travel Network business are untested in the market and are based on assumptions regarding volume, pricing and costs that may or may not prove to be accurate. Accordingly, our operating results could be adversely affected by new business models that replace the DCA 3-Year Options or that we otherwise offer to travel industry participants.

We cannot assure you that our arrangements with travel suppliers will remain in effect, that the net impact of these pricing options will not adversely impact revenue or the results of operations of one or more of our business units, or that any of these suppliers will continue to supply us with the same level of access to inventory of travel offerings in the future. Additionally, we cannot assure you that potential disputes with our travel suppliers (such as our litigation with Northwest Airlines) will not affect our businesses. See Part II - Item 1 Legal Proceedings. Because our major airline relationships represent such a large part of our business, the loss of any of our major airline relationships, including due to the bankruptcy of an airline, could have a material negative impact on our business. If our access to inventory or features is affected, or our ability to offer their inventory on comparatively favorable economic terms is diminished, it could have a material adverse effect on our business, financial condition or results of operations.

Consolidation in the travel industry and increased competition for travel agency subscribers may result in increased expenses, lost transactions and reduced revenue.

GDSs compete to attract and retain travel agencies. The number of transactions produced by our travel agency subscriber base is an important factor in our success. Some travel suppliers have reduced or eliminated commissions paid to travel agencies (including consumer-direct travel sites like Travelocity). The loss of commissions causes travel agencies to become more dependent on other sources of revenues, such as traveler-paid service fees and GDS-paid incentives. The reduction or elimination of supplier-paid commissions has forced some smaller travel agencies to close or to combine with larger travel agencies. Although the *Sabre* GDS has a leading share of large travel agencies, competition is particularly intense among global distribution systems for larger travel agency subscribers, including online travel agencies. Consolidation of travel agencies may result in increased competition for these subscribers. In order to compete effectively, we may need to increase incentives, pre-pay incentives, increase spending on marketing or product development, or make significant investments to purchase strategic assets. In addition, consolidation among travel suppliers, such as major hotels and airline mergers and alliances, may increase competition from these supplier-related distribution channels or give them additional leverage to negotiate lower transaction fees payable to GDS operators like Sabre Travel Network.

Travelocity s growth cannot be assured.

The online travel marketplace is highly competitive, with both independent online travel agencies and suppliers proprietary websites competing for customers. Our business strategy is dependent on expanding Travelocity s transaction revenues, increasing its percentage of merchant transactions, maintaining the breadth of its merchant suppliers, developing its brand in a cost-effective manner both in the United States and in other growth regions (such as Europe and Asia) and increasing its site traffic (including direct distribution as well as through current and future distribution partners). Key components of this strategy include the growth of revenue from our merchant model hotel business, last-minute packaging and the *TotalTrip* dynamic packaging offering. We also plan to expand the appeal of *Travelocity Business* to corporate travelers and to invest strategically in growth opportunities such as the European and Asian marketplaces, in large part through the acquisition of lastminute.com. If any of these initiatives is not successful or requires extensive investment, Travelocity s growth may be limited and it may be unable to achieve or maintain profitability. In addition, Travelocity s growth strategy relies on the continuing growth in the travel industry of the internet as a distribution channel. If consumers do not continue to book more travel online than they currently do today or if the use of the internet as a medium of commerce for travel bookings does not continue to grow or grows more slowly than expected, our revenues and profit may be adversely affected.

Our business plans call for the significant growth of our net rate hotel and packaging businesses, and we may be unsuccessful in managing or expanding that business.

Our business strategy is dependent for a significant source of revenue growth and increased margins upon our net rate programs, primarily our net rate hotel program, which are commonly referred to in the industry as a merchant model business because we are the merchant of record for credit card processing. Our net rate hotel strategy is particularly dependent upon our ability to obtain the right to offer adequate hotel rooms. We remain subject to numerous risks in the operation and growth of the net rate business. In particular, we cannot ensure that we will continue to be successful in adding and retaining hotel properties or other suppliers in a sufficient number of domestic or international geographic markets. Many hoteliers utilize net rate arrangements with us and with our competitors as a channel to dispose of excess hotel rooms at discounted rates. Demand for supplier offerings may increase as a result of increased travel and competition from net rate offerings by our competitors. If demand increases for suppliers products, services and other content offerings, suppliers may limit our right to distribute their offerings or may increase the cost of those offerings. These types of events could exert downward pressure on the margins we expect to achieve in our net rate hotel business. We may be unable to achieve our financial objectives for the net rate hotel program, especially if economic conditions improve or if competition increases. Similar risks could also impact any future net rate programs we might explore for other types of supplier offerings, such as air travel.

We may be unsuccessful in pursuing and integrating business combinations, strategic alliances, or products and technologies, which could result in increased expenditures or cause us to fail to achieve anticipated cost savings or revenue growth.

We are currently seeking to integrate the completed acquisitions described in this report, including our acquisitions of lastminute.com. In addition, we plan to continue to examine possible business combinations, investments, joint ventures or other strategic alliances with other companies in order to maintain and grow revenue and marketplace presence. As a result of these completed or potential transactions, our businesses will be subject to new or increased risks related to the nature of the transactions. We may be unable to successfully complete potential acquisitions due to multiple factors, such as issues related to regulatory review of the proposed transactions. In addition, there are risks inherent in these types of transactions, such as: difficulty in assimilating or integrating the operations, technology and personnel of the combined companies; difficulties and costs associated with integrating and evaluating the internal control systems of acquired businesses; disruption of our ongoing business, including loss of management focus on existing businesses and marketplace developments; problems retaining key technical and managerial personnel; expenses associated with the amortization of identifiable intangible assets; additional or unanticipated operating losses, expenses or liabilities of acquired businesses; impairment of relationships with existing employees, customers and business partners; and fluctuations in value and losses that may arise from equity investments. In addition, we may not be able to: identify suitable candidates for additional business combinations and strategic investments; obtain financing on acceptable terms for such business combinations and strategic investments; or otherwise consummate such business combinations and strategic investments on acceptable terms. To consummate such transactions, we may need to raise external funds through the sale of stock and/or debt in the capital markets or through private placements, which might affect our liquidity requirements.

We expect to realize strategic and other benefits as a result of our acquisition of lastminute.com. Our ability to realize these benefits or successfully integrate lastminute.com s businesses, however, is subject to certain risks and uncertainties, including:

The costs of integrating lastminute.com and upgrading and enhancing its operations may be higher than we expect and may require more resources, capital expenditures and management attention than anticipated.

Employees important to lastminute.com s operations may decide not to continue employment under our ownership.

We may be unable to maintain and enhance our relationship with lastminute.com s existing customers and suppliers.

We may be unable to anticipate or manage risks that are unique to lastminute.com s business, including those related to its workforce, customer demographics, regulatory environment, information systems, culture and geography.

To replace the Bridge Facility financing we utilized to consummate the lastminute.com acquisition, we will need to raise external funds through the sale of securities in the public capital markets or through private transactions, which might affect our liquidity and capital resources or cause dilution to common stockholders.

We have initiated our efforts to assess the internal controls over financial reporting related to lastminute.com s business but we do not expect to report on the assessment until 2006. The lastminute.com business may have significant deficiencies or material weaknesses in their internal controls over financial reporting. We will attempt to promptly resolve identified deficiencies and weaknesses, but we may not identify significant deficiencies or material weaknesses until our assessment is nearly completed and we cannot provide assurance that existing internal controls over financial reporting will be able to detect or prevent material reporting errors or fraud. We may incur significant additional costs to resolve deficiencies in internal controls and disclosure controls.

Our failure to manage these risks, or other risks related to the acquisition that are not presently known to us, could prevent us from realizing the expected benefits of the acquisition and also may have a material adverse effect on our results of operations and financial condition.

We are not certain that our ongoing cost reduction plans will continue to be successful.

Our strategy depends, to a substantial degree, on reducing and controlling operating expenses. In furtherance of this strategy, we have engaged in ongoing, company-wide activities intended to reduce costs. These activities include personnel reductions, reductions in personnel-related costs, programs designed to reduce the growth rate of incentive payments to travel agencies, and realigning and streamlining operations and consolidating facilities. We cannot assure you that our efforts will continue to result in the increased profitability, cost savings or other benefits that we expect.

Part of our cost reduction strategy involves leveraging our status as a global company to conduct some of our operations outside the United States, such as customer call centers and software development, either by contracting with foreign companies that work for us or by expanding our own operations outside the United States. These foreign operations are subject to unique risks, including: business, political and economic instability in foreign locations; governments policies that could adversely affect business and economic conditions related to our operations or business; adverse political or consumer reactions in the United States; disruptions to communication and transportation services supporting globalization; actual or threatened terrorist activities; and military action overseas. Risks such as these could adversely affect our ability to effectively implement global sourcing.

Rapid technological changes and new distribution channels or unauthorized use of our intellectual property may adversely affect the value of our current or future technologies to us and our customers, which could cause us to increase expenditures to upgrade and protect our technology or develop and protect competing offerings in new distribution channels.

New distribution channels and technology in our industry are evolving rapidly. Our ability to compete and our future results depend in part on our continued ability to maintain and to make timely and cost-effective enhancements, upgrades and additions to our technology in response to changes in consumer preferences and increased demand for our products and services. We must also keep pace with rapid advancements in industry technology, standards and practices, and protect our technology. Additionally, we must maintain our ability to ensure the security and privacy of personal information transmitted through our websites and other distribution channels. Unauthorized use of our intellectual property could have a material adverse effect on us, and our legal remedies may not adequately compensate us for the damages to our business caused by such use. Protecting our intellectual property from unauthorized use could be expensive and time consuming. Maintaining flexibility to respond to technological and marketplace dynamics or to respond to evolving security and privacy requirements may require substantial expenditures and lead-time. We cannot assure you that we will successfully identify and develop new products or services in a timely manner, that offerings, technologies or services developed by others will not render our offerings obsolete or noncompetitive, or that the technologies in which we focus our research and development investments will achieve acceptance in the marketplace and provide a return on our investment.

Our systems may suffer failures, capacity constraints and business interruptions, which could increase our operating costs and cause us to lose customers.

Our businesses are largely dependent on the computer data centers and network systems operated for us by Electronic Data Systems Corporation and on the global telecommunications infrastructure. We rely on several communications service suppliers and on the global Internet to provide network access between our computer data center and call centers and end-users of our services. Both the Travelocity and *Site59*® businesses are dependent upon GDS s (the *Sabre* GDS and a third-party provider, respectively) to process their travel bookings. We occasionally experience system interruptions that make some or all of our global distribution system or other data processing services (including the services that Sabre Airline Solutions provides to airlines) unavailable, which may prevent us from efficiently providing services to our customers or other third parties and which could result in our losing customers or becoming liable to them as a result of these interruptions. System capacity limits or constraints arising from unexpected increases in our volume of business could cause interruptions, outages or delays in our services, or deterioration in their performance, or could impair our ability to process transactions. Much of the computer and communications hardware upon which we depend is located in a single facility. Our systems might be damaged or interrupted by fire, flood, power loss, telecommunications failure, break-ins, earthquakes, terrorist attacks, hostilities or war or similar events. Computer viruses, physical or electronic break-ins and similar disruptions affecting the global Internet or our systems might cause service interruptions, delays and loss of critical data, and could prevent us from providing our services. Problems affecting our systems might be expensive to remedy and could significantly diminish our reputation and brand name and prevent us from providing services. We could be harmed by outages in, or unreliability of, the data center or network systems. The occurrence of any of these events could result in a material adverse effect on our business, financial condition or results of operations (particularly if such events occur at Travelocity).

Our success depends on maintaining the integrity of, and upgrading the quality of, our systems and infrastructure.

In order to be successful, we must provide reliable, real-time access to our systems for our customers and suppliers while also pursuing a low-cost model. As our operations grow in both size and scope, we will continuously need to improve and upgrade our systems and infrastructure to offer an increasing number of customers and travel suppliers enhanced products, services, features and functionality all while maintaining the reliability and integrity of our systems and infrastructure and while pursuing the lowest cost per transaction. The expansion of our systems and infrastructure will require us to commit substantial financial, operational and technical resources before the volume of business increases, with no assurance that the volume of business will increase. Consumers and suppliers will not tolerate a service hampered by slow delivery times, unreliable service levels, service outages due to the installation of upgrades, or insufficient capacity, any of which could have a material adverse effect on our business, financial condition or results of operations.

Our processing, storage, use and disclosure of personal data could give rise to liabilities as a result of governmental regulation, conflicting legal requirements or differing views of personal privacy rights.

In our processing of travel transactions, we receive and store a large volume of personally identifiable data. This data is increasingly subject to legislation and regulations in numerous jurisdictions around the world, including the Commission of the European Union (E.U. Commission) through its Data Protection Directive and variations of that directive in the member states of the European Union (E.U.). This government action is typically intended to protect the privacy of personal data that is collected, processed and transmitted in or from the governing jurisdiction. We could be adversely affected if legislation or regulations are expanded to require changes in our business practices or if governing jurisdictions interpret or implement their legislation or regulations in ways that negatively affect our business, financial condition and results of operations.

In addition, in the aftermath of the terrorist attacks of September 11, 2001 in the United States, government agencies have been contemplating or developing initiatives to enhance national and aviation security, including the Transportation Security Administration s Computer-Assisted Passenger Prescreening System, known as CAPPS II. These initiatives may result in conflicting legal requirements with respect to data handling. As privacy and data protection has become a more sensitive issue, we may also become exposed to potential liabilities as a result of differing views on the privacy of travel data. Travel businesses have also been subjected to investigations, lawsuits and adverse publicity due to allegedly improper disclosure of passenger information. These and other privacy developments that are difficult to anticipate could adversely impact our business, financial condition and results of operations.

State and local tax issues have the potential to have an adverse effect on our financial condition and results of operations.

Some state and local taxing authorities impose taxes on the sale, use or occupancy of hotel room accommodations, which are called transient, occupancy, accommodation, sales or hotel room taxes. Hotel operators generally collect and remit these occupancy taxes. Consistent with that practice, when a customer books a hotel room through one of our travel services under our net rate hotel program, we collect from the customer an amount sufficient to pay the hotel its room charge and the occupancy taxes on that charge, as well as additional amounts representing our fees.

We do not collect or remit occupancy taxes on our fees. Some tax authorities claim that occupancy taxes should be collected on some or all of the fees. We believe there are strong arguments that our fees are not subject to occupancy taxes (although tax laws vary among the jurisdictions). We are attempting to resolve this issue with tax authorities in various jurisdictions, but we cannot predict the resolution in any particular jurisdiction.

We have established a reserve for potential occupancy tax liability, consistent with applicable accounting principles and in light of all current facts and circumstances. The reserve represents our best estimate of our contingent liability for occupancy taxes. A variety of factors could affect any actual liability for occupancy taxes, such as the number of jurisdictions that prevail in either assessing additional occupancy taxes or negotiating a settlement with us, the fees potentially subject to tax in each jurisdiction, changes in applicable tax laws, and the timing of any or all of the foregoing. The amount of our liability on occupancy taxes could exceed that reserve, which could have a material adverse effect on our financial results.

Regulatory developments abroad could limit our ability to compete by restricting our flexibility to respond to competitive conditions, which could cause our customers to be diverted to our competitors and adversely affect our revenue and results of operations.

The E.U. Commission is engaged in a comprehensive review of its rules governing CRS systems. It is unclear when the E.U. Commission will complete its review and what changes, if any, will be made to its CRS rules. We could be unfairly and adversely affected if, for example, these rules are retained as to traditional global distribution systems used by travel agencies but are not applied to travel distribution websites owned by more than one airline. We could also be adversely affected if restrictions are imposed or continued on CRS advertising and displays or if additional limitations are placed upon our right to contract with travel agents or airlines.

We could also be adversely affected if changes to any of the foregoing CRS rules increase our cost of doing business or weaken the non-discriminatory participation rules to allow one or more large airlines owning a competing CRS to discontinue or to lower its level of participation in our global distribution system.

Our international operations are subject to other risks, which may impede our ability to grow internationally and adversely affect our overall results of operations.

We continually seek to expand the reach of our various businesses into international markets as well as to successfully integrate, operate and manage our existing and future international operations. Our international operations are subject to a number of risks, including, but not limited to, the following:

changes in foreign currency exchange rates,

competition from local businesses, which may have a better understanding of, and ability to focus on, local consumers and their preferences, as well as more established local brand recognition and better access to local financial and strategic resources,

difficulty in developing, managing and staffing international operations as a result of distance, language and cultural differences,

local economic and political conditions, including conditions resulting from the existing and potential conflicts in the Middle East and the damage resulting from the tsunami that devastated large parts Southeast Asia,

restrictive governmental actions, such as consumer and trade protection measures,

changes in legal or regulatory requirements, including changes to foreign tax laws,

limitations on the repatriation of funds,

lesser protection in some jurisdictions for our intellectual property, and

laws and policies of the U.S. affecting trade, foreign investment and loans.

These risks may adversely affect our ability to conduct and grow business internationally, which could cause us to increase expenditures and costs, decrease our revenue growth or both.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

At June 30, 2005, our exposure to interest rates was related primarily to our marketable securities portfolio. Offsetting some of this exposure was the fixed to floating interest rate swaps on our public notes and capital lease. The objectives of our marketable securities are safety of principal, liquidity maintenance, yield maximization and full investment of all available funds. As such, our investment portfolio consists primarily of high credit quality money market mutual funds, certificates of deposit, bankers acceptances, commercial paper, mortgage-backed and receivables-backed securities and corporate and government notes, including tax-exempt municipal securities. If short-term interest rates had been 10% lower during the six months ended June 30, 2005, our interest income from marketable securities would have decreased by approximately $0.8 million. This amount was determined by applying the hypothetical interest rate change to our average balance of marketable securities during the six months ended June 30, 2005.

At June 30, 2005 we had obligations under fixed rate notes of $400 million (Notes) and a $168 million capital lease obligation. We entered into fixed to floating interest rate swaps related to $300 million of the outstanding Notes, effectively converting $300 million of the $400 million fixed rate Notes into floating rate obligations. We also entered into a fixed to floating interest rate swap that effectively converts $100 million of the capital lease obligation into a floating rate obligation (see Note 6 to the Consolidated Financial Statements for additional details on the swaps). If short-term interest rates had been 10% higher during the six months ended June 30, 2005, our interest expense would have increased by approximately $0.6 million. This amount was determined by applying the hypothetical interest rate change to our floating rate borrowings balance during six months ended June 30, 2005. If our mix of interest rate-sensitive assets and liabilities changes significantly, we may enter into additional derivative transactions to manage our net interest rate exposure.

Foreign Currency Risk

We have various operations outside of the United States, primarily in North America, South America, Europe, Australia and Asia. As a result of these business activities, we are exposed to foreign currency risk. Because a significant portion of our business is transacted in the United States dollar, these exposures have historically related to a small portion of our overall operations. Nevertheless, during times of devaluation of the U.S. dollar, such as in 2003 and 2004, the increase in our foreign expenses can have a negative impact on our operating results. To reduce the impact of this earnings volatility, we hedge a portion of our foreign currency exposure by entering into foreign currency forward contracts on our three largest foreign currency exposures. These forward contracts, totaling $115 million at December 31, 2004 and $122 million at June 30, 2005, represent obligations to purchase foreign currencies at a predetermined exchange rate, to fund a portion of our expenses that are denominated in foreign currencies. In December 2004, we purchased foreign currency denominated government bonds to function as a hedge of a portion of our 2005 foreign currency exposure. To protect these bond investments from foreign currency risk, we purchased put options on the currencies in which the government bonds are denominated. These options give us the right to sell the foreign currencies at predetermined prices. The result of an immediate 10% devaluation of the U.S. dollar in 2005 from June 30, 2005 levels relative to our primary foreign currency exposures would result in a negative U.S. dollar impact of approximately $2.8 million for the remainder of 2005, net of hedge instruments outstanding. This sensitivity analysis was prepared based upon 2005 projections of our primary foreign currency-denominated expenses and foreign currency forwards and foreign currency denominated bonds outstanding as of June 30, 2005.

Item 4. Controls and Procedures

Controls Evaluation and Related CEO and CFO Certifications. Our management, with the participation of our principal executive officer (CEO) and principal financial officer (CFO) conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report. The controls evaluation was conducted by our Disclosure Controls Council, comprised of senior representatives from our Finance, Accounting, Internal Audit, Tax, Investor Relations, Corporate Communications and Legal Departments under the supervision of our CEO and CFO.

Attached as exhibits to this Quarterly Report are certifications of our CEO and our CFO, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (Exchange Act). This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Limitations on the Effectiveness of Controls. We do not expect that our disclosure controls and procedures will prevent all errors and all fraud. A system of controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. Because of the limitations in all such systems, no evaluation can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Furthermore, the design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how unlikely. Because of these inherent limitations in a cost-effective system of controls and procedures, misstatements or omissions due to error or fraud may occur and not be detected.

Scope of the Controls Evaluation. The evaluation of our disclosure controls and procedures included a review of their objectives and design, the Company s implementation of the controls and procedures and the effect of the controls and procedures on the information generated for use in this Quarterly Report. In the course of the evaluation, we sought to identify whether we had any data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, were being undertaken if needed. This type of evaluation is performed on a quarterly basis so that conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our Quarterly Reports on Form 10-Q, which supplement our disclosures made in our Annual Report on Form 10-K. Many of the components of our disclosure controls and procedures are also evaluated by our Internal Audit Department, our Legal Department and by personnel in our Finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures on an ongoing basis, and to maintain them as dynamic systems that change as conditions warrant.

Conclusions regarding disclosure controls. Based on the required evaluation of our disclosure controls and procedures, our CEO and CFO have concluded that, as of June 30, 2005, we maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in internal controls over financial reporting. During the quarter ended June 30, 2005, there were no changes in our internal control over financial reporting (or in other factors) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

On July 20, 2005, our acquisition of lastminute.com became effective. We believe the acquisition of lastminute.com will be material to our results of operations, financial position and cash flows from the date of acquisition, and we believe the internal controls and procedures of lastminute.com are reasonably likely to materially affect the Company s internal control over financial reporting. We will begin our integration of lastminute.com in the third quarter of 2005.

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PART II: OTHER INFORMATION

Item 1. Legal Proceedings

The litigation matters described below involve issues or claims that may be of particular interest to the Company s stockholders, regardless of whether any of these matters may be material to the financial position or operations of the Company based upon standards set forth in SEC rules.

We are party to two lawsuits (which as described below have now been consolidated in federal court in Fort Worth, Texas) against Northwest Airlines, Inc. (Northwest) related to Northwest s August 24, 2004 announcement and implementation on September 1, 2004 of a fare supplement for travel reservation bookings made through a GDS (including the *Sabre* GDS) by traditional travel agencies and some online travel sites (such as Travelocity). We notified Northwest that it was in breach of the parties Participating Carrier Distribution and Services Agreement (PCA), as amended by the DCA 3-Year Option Agreement. We also took commercial steps, which we believed were reasonable under the DCA 3-Year Option Agreement and PCA, in order to enforce both agreements.

The Company sued Northwest on August 24, 2004 in Sabre Inc. v. Northwest Airlines, Inc., Civil Action 4-04-CV-612-Y in the Fort Worth Division of the United States District Court for the Northern District of Texas (hereinafter the Fort Worth Action). We allege that Northwest breached the PCA, as amended by the DCA 3-Year Option Agreement. Among other things, the DCA 3-Year Option Agreement requires that Northwest provide us with fares and other content for the *Sabre* GDS that Northwest makes available through other channels of ticket distribution. We believe that Northwest breached the DCA 3-Year Option Agreement by imposing a charge on tickets booked on the *Sabre* GDS but not on other channels of ticket distribution. We seek monetary damages, attorneys fees, and to compel Northwest to adhere to the terms of their agreements.

On August 25, 2004, Northwest sued Sabre Holdings Corporation, Sabre Inc. and Sabre Travel International Ltd. in a separate action styled Northwest Airlines Corporation v. Sabre Inc. et al., Cause No. 04-CV-03889 in Minneapolis federal court (hereinafter the Minneapolis Action). The Minneapolis Action related to the same factual events described above. In its complaint filed on August 25, 2004, Northwest asserted that we breached our PCA with Northwest by our commercial actions in response to Northwest s August 24, 2004 breach of the PCA. On September 27, 2004, Northwest filed an amended complaint in the same cause number adding allegations that we had violated Section 2 of the Sherman Act, claiming that we had monopoly power, and also asserting claims against us for alleged interference with prospective contractual relations, deceptive trade practices, fraud, false advertising under the federal Lanham Act, and for a declaratory judgment that Sabre, and not Northwest, is in breach of the PCA. Northwest alleges that it has suffered unspecified damages. Northwest seeks treble damages under the antitrust laws, attorneys fees, to have the court declare that we breached the parties agreement and violated federal and state statutes, and to enjoin us from certain conduct.

On November 9, 2004, the Court in the Fort Worth Action rejected Northwest s motion to transfer that case to the federal court in Minneapolis, following which Northwest agreed to have the Minneapolis Action transferred to Fort Worth. The two cases have now been consolidated before the Court in Fort Worth. On January 13, 2005, the Company filed a motion with the Court to dismiss Northwest s antitrust claims and its claims under various Minnesota state statutes and tort law theories. That motion has now been fully briefed and is ripe for decision by the Court. In addition, both parties are pursuing the discovery process in the litigation.

We are unable to estimate the amount of the loss, if any, that might arise from this litigation.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) (b) None.

(c) The following table provides information about purchases by the company (and its affiliated purchasers) during the three months ended June 30, 2005 of equity securities that are registered by the company pursuant to Section 12 of the Exchange Act.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Weighted Average Price Paid per Share		Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Dollar Value of Shares That May Yet be Purchased Under the Programs	
April 1, 2005 April 30, 2005		$	n/a		$	
May 1, 2005 May 31, 2005		$	n/a		$	100,000,000
June 1, 2005 June 30, 2005		$	n/a		$	100,000,000
Total 2nd Quarter 2005 Repurchases		$	n/a			

On October 25, 2004, our Board of Directors approved a share repurchase program authorizing us to repurchase up to $100 million of our Common Stock. This program was announced on October 28, 2004. We completed this authorization in March 2005 with the purchase of 2,042,063 shares of our Common Stock during the first three months of 2005. All purchases were made through the open market pursuant to 10b5-1 trading plans.

On May 2, 2005, we received authorization from our Board of Directors to repurchase an additional $100 million of our Common Stock. Due to the acquisition of lastminute.com, no purchases of our Common Stock have been made under this authorization as of the date of this report. As in the past, implementation of the program is at management s discretion and will depend on the best uses for our available cash.

On October 20, 2003 our Board of Directors issued a standing annual authorization to purchase shares of our Common Stock to satisfy our obligations to deliver shares under our Employee Stock Purchase Plan and our Long-Term Incentive Plan (the Alternative Share Settlement Program). We purchased 840,000 shares of our Common Stock under this authorization in January 2005 through the open market pursuant to 10b5-1 trading plans.

We expect that the timing, volume and price of any future repurchases of our Common Stock will be made pursuant to trading plans that we intend as qualifying under Rule 10b5-1, unless such plans are terminated at the discretion of management.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

The annual meeting of the stockholders of Sabre Holdings Corporation was held on May 17, 2005. The owners of 114,897,560 shares of Sabre Holdings Corporation Class A Common Stock (Common Stock), representing 87.69 percent of the voting power of all of the shares of Common Stock issued and outstanding on March 18, 2005, the record date for the meeting, were represented at the annual meeting. Each share of Common Stock was entitled to one vote at the annual meeting.

Our stockholders elected each of the following individuals as a director of Sabre Holdings Corporation for a term of one year: Michael S. Gilliland (93,923,846 votes in favor, 20,973,714 votes withheld), Bob L. Martin (102,279,221 votes in favor, 12,618,339 votes withheld), and Richard L. Thomas (102,886,880 votes in favor, 12,010,680 votes withheld). Because our proposal to amend our certificate of incorporation to provide for the annual election of all directors was approved by the stockholders, all of our directors will stand for election annually commencing at the annual meeting in 2006 (see below for additional details).

Our stockholders ratified the appointment of Ernst & Young LLP as independent auditors for the Company for the year ending December 31, 2005 with 112,463,366 votes in favor, 1,593,056 votes against and 841,138 abstentions.

Our stockholders approved the amendment of the Company s certificate of incorporation to provide for the annual election of all directors. This proposal to amend the certificate of incorporation was approved with 113,798,868 votes in favor, 226,600 votes against, and 872,092 abstentions.

Our stockholders also approved the amendment of the Company s certificate of incorporation to make miscellaneous changes to better reflect our governance practices, clarify existing wording, enhance readability, apply a consistent paragraph numbering system, and make various ministerial and formatting changes. This proposal to amend the certificate of incorporation received 112,423,563 votes in favor, 84,204 votes against, and 2,389,793 abstentions.

The Third Restated Certificate of Incorporation reflecting the foregoing amendments, as filed with the Secretary of State of the State of Delaware on May 17, 2005, is attached hereto as Exhibit 3.1.

Our stockholders approved the Company s Amended and Restated 2005 Long-Term Incentive Plan, as Amended May 17, 2005 (LTIP), in order to combine and increase the authorization for restricted shares and other full value stock-based awards to 5,000,000 shares, to increase the cap on awards of performance shares per individual, to make changes intended to bring the plan into compliance with the American Jobs Creation Act of 2004 (AJCA), to revise the definition of Cause to align with the Corporation s other employee plans, to remove all references to retirement, and to make various other ministerial and formatting changes. The proposal to amend and restate the long-term incentive plan received 80,930,927 votes in favor, 22,883,623 votes against, 1,150,254 abstentions, and 9,932,756 broker non-votes. The total number of shares of our Common Stock reserved under the LTIP did not change as a result of this proposal. The LTIP reflecting the foregoing amendments is attached hereto as Exhibit 10.1.

Item 5. Other Information

(a) None.

(b) None.

Item 6. Exhibits

The following exhibits are included herein:

Exhibit Number	Description of Exhibit
2.1	Form of Implementation Agreement dated as of May 12, 2005 between Sabre Inc., Travelocity Europe Limited and lastminute.com plc (1)
2.2	Form of Scheme of Arrangement dated as of June 6, 2005 between Sabre Inc., Travelocity Europe Limited and lastminute.com plc (2)
2.3	Form of Letter dated as of June 8, 2005 to holders of options granted under the lastminute.com plc 2000 Approved Executive Share Option Scheme and 2000 Unapproved Executive Share Option Scheme (5)
2.4	Form of Letter dated as of June 8, 2005 to holders of out-of-the-money options granted under the lastminute.com plc 1999 Unapproved Executive Share Option Scheme (6)
2.5	Form of Letter dated as of June 8, 2005 to Mr. A. Leighton in respect of options granted under the Non-Executive Scheme (7)
2.6	Form of Letter dated as of June 8, 2005 to holders of out-of-the-money options granted under the lastminute.com plc 2000 Approved Executive Share Option Scheme and 2000 Unapproved Executive Share Option Scheme (8)
2.7	Form of Letter dated as of June 8, 2005 to holders of options granted under the lastminute.com plc 1998 Unapproved Executive Share Option Scheme and 1999 Unapproved Executive Share Option Scheme (9)
2.8	Form of Letter dated as of June 8, 2005 to holders of options granted under the lastminute.com plc Sharesave Scheme (10)
2.9	Form of Bondholder Circular dated as of June 6, 2005 (11)
3.1	Third Restated Certificate of Incorporation of Sabre Holdings Corporation (12)
3.2	Amended and Restated Bylaws of Sabre Holdings Corporation (13)
10.1	Form of Amended and Restated 2005 Long-Term Incentive Plan (3)
10.2	Form of Credit Agreement dated as of May 12, 2005 among Sabre Inc., Morgan Stanley Senior Funding, Inc., and Bear, Sterns & Co., Inc. (3)
10.3	Form of Cash Confirmation Letter dated as of May 12, 2005 by Sabre Inc. and Travelocity Europe Limited (3)
10.4	Form of LTIP Letter dated as of June 21, 2005 (3)
10.5	Form of Options Cover Statement dated as of June 8, 2005 (3)
12.1	Computation of Ratio of Earnings to Fixed Charges (3)
31.1	Written statement pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated August 5, 2005, signed by Michael S. Gilliland as Chief Executive Officer (3)
31.2	Written statement pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated August 5, 2005, signed by Jeffery M. Jackson as Chief Financial Officer (3)
32.1	Written statement pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated August 5, 2005, signed by Michael S. Gilliland as Chief Executive Officer (4)
32.2	Written statement pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated August 5, 2005, signed by Jeffery M. Jackson as Chief Financial Officer (4)

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(1) Incorporated by reference to Exhibit 2.1 to our report on Form 8-K dated July 20, 2005.

(2) Incorporated by reference to Exhibit 2.2 to our report on Form 8-K dated July 20, 2005.

(3) Filed herewith.

(4) Sabre Holdings Corporation is furnishing, but not filing, the written statements pursuant to Title 18 United States Code 1350, as added by Section 906 to the Sarbanes-Oxley Act of 2002, of Michael S. Gilliland, the Chief Executive Officer of Sabre Holdings Corporation and Jeffery M. Jackson, the Chief Financial Officer of Sabre Holdings Corporation.

(5) Incorporated by reference to Exhibit 2.3 to our report on Form 8-K dated July 20, 2005.

(6) Incorporated by reference to Exhibit 2.4 to our report on Form 8-K dated July 20, 2005.

(7) Incorporated by reference to Exhibit 2.5 to our report on Form 8-K dated July 20, 2005.

(8) Incorporated by reference to Exhibit 2.6 to our report on Form 8-K dated July 20, 2005.

(9) Incorporated by reference to Exhibit 2.7 to our report on Form 8-K dated July 20, 2005.

(10) Incorporated by reference to Exhibit 2.8 to our report on Form 8-K dated July 20, 2005.

(11) Incorporated by reference to Exhibit 2.9 to our report on Form 8-K dated July 20, 2005.

(12) Incorporated by reference to Exhibit 4.1 to our report on Form S-8 dated July 28, 2005.

(13) Incorporated by reference to Exhibit 3.2 to our report on Form 8-K dated July 28, 2005.

PLEASE NOTE: Exhibits 2.1 through 2.9 and 10.2 of this report are provided to disclose the material terms and conditions of those exhibits. The exhibits contain contractual representations, warranties, covenants and other statements (collectively, statements) made as of the dates specified in the exhibits, and information may have changed since the dates specified. Certain statements may not be accurate or complete because they may have been intended as allocations of risk between the parties, rather than as expressions of fact or projections. Certain of the statements may be qualified by contractual standards of materiality that differ from the standard of materiality under U.S. federal securities laws. Moreover, a party may have provided, or may later provide, confidential information that qualifies or supersedes the statements in exhibits, which information the Company does not intend to disclose publicly. Therefore, you should not rely on any of the statements contained in exhibits 2.1 through 2.9 and 10.2 as expressions of fact or projections about Sabre Holdings or lastminute.com.

Signature

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

Date: August 5, 2005	SABRE HOLDINGS CORPORATION	
	By:	/s/ JEFFERY M. JACKSON Jeffery M. Jackson *Executive Vice President, Chief Financial Officer and Treasurer* *(Principal Financial Officer)*
	By:	/s/ MARK K. MILLER Mark K. Miller *Senior Vice President and Controller* *(Principal Accounting Officer)*