BANK OF HAWAII CORP
Form 10-Q
July 25, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2007**
	or
o	**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to**

Commission File Number: 1-6887

BANK OF HAWAII CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**99-0148992**
(State of incorporation)	(I.R.S. Employer Identification No.)
130 Merchant Street, Honolulu, Hawaii	**96813**
(Address of principal executive offices)	(Zip Code)

1-888-643-3888
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

As of July 20, 2007, there were 49,353,090 shares of common stock outstanding.

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Bank of Hawaii Corporation and Subsidiaries
Consolidated Statements of Income (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(dollars in thousands, except per share amounts)	**2007**	**2006**	**2007**	**2006**
Interest Income				
Interest and Fees on Loans and Leases	$ 112,026	$ 104,388	$ 222,324	$ 203,759
Income on Investment Securities				
Trading	1,357	-	2,975	-
Available-for-Sale	31,563	31,226	62,524	62,061
Held-to-Maturity	3,827	4,658	7,879	9,415
Deposits	96	55	154	98
Funds Sold	533	170	1,591	295
Other	364	272	697	544
Total Interest Income	149,766	140,769	298,144	276,172
Interest Expense				
Deposits	33,701	24,656	67,076	44,289
Securities Sold Under Agreements to Repurchase	11,665	9,802	23,551	17,692
Funds Purchased	1,452	2,652	2,375	4,545
Short-Term Borrowings	91	73	178	130
Long-Term Debt	3,979	3,730	7,949	7,458
Total Interest Expense	50,888	40,913	101,129	74,114
Net Interest Income	98,878	99,856	197,015	202,058
Provision for Credit Losses	3,363	2,069	5,994	4,830
Net Interest Income After Provision for Credit Losses	95,515	97,787	191,021	197,228
Noninterest Income				
Trust and Asset Management	16,135	14,537	31,968	29,385
Mortgage Banking	2,479	2,569	5,850	5,556
Service Charges on Deposit Accounts	11,072	9,695	22,039	19,827
Fees, Exchange, and Other Service Charges	16,556	15,633	32,617	30,400
Investment Securities Gains, Net	575	-	591	-
Insurance	4,887	4,691	11,102	9,710
Other	6,324	6,076	14,821	10,895
Total Noninterest Income	58,028	53,201	118,988	105,773
Noninterest Expense				
Salaries and Benefits	44,587	44,811	89,993	90,597
Net Occupancy	9,695	9,376	19,506	19,019
Net Equipment	4,871	4,802	9,658	9,830
Professional Fees	2,599	2,589	5,142	3,027
Other	18,080	17,164	37,656	37,087
Total Noninterest Expense	79,832	78,742	161,955	159,560
Income Before Provision for Income Taxes	73,711	72,246	148,054	143,441
Provision for Income Taxes	25,982	35,070	52,990	60,915
Net Income	$ 47,729	$ 37,176	$ 95,064	$ 82,526
Basic Earnings Per Share	$ 0.97	$ 0.74	$ 1.93	$ 1.63
Diluted Earnings Per Share	$ 0.95	$ 0.72	$ 1.89	$ 1.59
Dividends Declared Per Share	$ 0.41	$ 0.37	$ 0.82	$ 0.74
Basic Weighted Average Shares	49,265,698	50,456,121	49,346,306	50,633,911
Diluted Weighted Average Shares	50,066,097	51,491,585	50,168,203	51,748,350

The accompanying notes are an integral part of the Consolidated Financial Statements (Unaudited).

Bank of Hawaii Corporation and Subsidiaries
Consolidated Statements of Condition (Unaudited)

(dollars in thousands)	June 30, 2007	December 31, 2006	June 30, 2006
Assets			
Interest-Bearing Deposits	$ 130,732	$ 4,990	$ 4,145
Funds Sold	200,000	50,000	-
Investment Securities			
Trading	123,591	-	-
Available-for-Sale			
Portfolio	1,683,417	1,846,742	2,177,220
Pledged as Collateral	772,251	751,135	334,947
Held-to-Maturity (Fair Value of $313,589; $360,719; and $408,203)	327,118	371,344	426,910
Loans Held for Sale	13,527	11,942	15,506
Loans and Leases	6,566,126	6,623,167	6,441,625
Allowance for Loan and Lease Losses	(90,998)	(90,998)	(91,035)
Net Loans and Leases	6,475,128	6,532,169	6,350,590
Total Earning Assets	9,725,764	9,568,322	9,309,318
Cash and Noninterest-Bearing Deposits	345,226	398,342	397,061
Premises and Equipment	122,929	125,925	130,435
Customers Acceptances	2,234	1,230	646
Accrued Interest Receivable	49,121	49,284	45,343
Foreclosed Real Estate	48	407	188
Mortgage Servicing Rights	29,112	19,437	18,750
Goodwill	34,959	34,959	34,959
Other Assets	413,175	373,909	388,490
Total Assets	$ 10,722,568	$ 10,571,815	$ 10,325,190
Liabilities			
Deposits			
Noninterest-Bearing Demand	$ 1,896,335	$ 1,993,794	$ 1,976,051
Interest-Bearing Demand	1,755,646	1,642,375	1,602,914
Savings	2,923,168	2,690,846	2,691,029
Time	1,739,255	1,696,379	1,496,039
Total Deposits	8,314,404	8,023,394	7,766,033
Funds Purchased	90,650	60,140	353,700
Short-Term Borrowings	15,644	11,058	12,100
Securities Sold Under Agreements to Repurchase	910,302	1,047,824	835,563
Long-Term Debt	260,329	260,288	242,749
Banker s Acceptances	2,234	1,230	646
Retirement Benefits Payable	43,892	48,309	72,192
Accrued Interest Payable	18,292	22,718	13,023
Taxes Payable and Deferred Taxes	277,516	277,202	274,146
Other Liabilities	80,499	100,232	88,310
Total Liabilities	10,013,762	9,852,395	9,658,462
Shareholders Equity			
Common Stock ($.01 par value; authorized 500,000,000 shares; issued / outstanding: June 2007 - 56,927,022 / 49,440,204; December 2006 - 56,848,609 / 49,777,654; and June 2006 - 56,855,346 / 50,570,697)	566	566	566
Capital Surplus	480,389	475,178	469,461
Accumulated Other Comprehensive Loss	(45,705)	(39,084)	(76,204)
Retained Earnings	645,149	630,660	581,406
Treasury Stock, at Cost (Shares: June 2007 - 7,486,818; December 2006 - 7,070,955; and June 2006 - 6,284,649)	(371,593)	(347,900)	(308,501)
Total Shareholders Equity	708,806	719,420	666,728
Total Liabilities and Shareholders Equity	$ 10,722,568	$ 10,571,815	$ 10,325,190

The accompanying notes are an integral part of the Consolidated Financial Statements (Unaudited).

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Bank of Hawaii Corporation and Subsidiaries

Consolidated Statements of Shareholders Equity (Unaudited)

(dollars in thousands)	Total	Common Stock	Capital Surplus	Accum. Other Compre-hensive Loss	Retained Earnings	Deferred Stock Grants	Treasury Stock	Compre-hensive Income
Balance as of December 31, 2006	$ 719,420	$ 566	$ 475,178	$ (39,084)	$ 630,660	$ -	$ (347,900)	
Cumulative-Effect Adjustment of a Change in Accounting Principle, Net of Tax:								
SFAS No. 156, *Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140*	5,126	-	-	5,279	(153)	-	-	
FSP No. 13-2, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction*	(27,106)	-	-	-	(27,106)	-	-	
FIN 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*	(7,247)	-	-	-	(7,247)	-	-	
Comprehensive Income:								
Net Income	95,064	-	-	-	95,064	-	-	$ 95,064
Other Comprehensive Income, Net of Tax:								
Change in Unrealized Gains and Losses on Investment Securities Available-for-Sale	(12,316)	-	-	(12,316)	-	-	-	(12,316)
Amortization of Prior Service Credit and Net Actuarial Loss	416	-	-	416	-	-	-	416
Total Comprehensive Income								$ 83,164
Share-Based Compensation	2,748	-	2,748	-	-	-	-	
Common Stock Issued under Share-Based Compensation Plans and Related Tax Benefits (444,008 shares)	14,615	-	2,463	-	(5,312)	-	17,464	
Common Stock Repurchased (779,689 shares)	(41,157)	-	-	-	-	-	(41,157)	
Cash Dividends Paid	(40,757)	-	-	-	(40,757)	-	-	
Balance as of June 30, 2007	$ 708,806	$ 566	$ 480,389	$ (45,705)	$ 645,149	$ -	$ (371,593)	
Balance as of December 31, 2005	$ 693,352	$ 565	$ 473,338	$ (47,818)	$ 546,591	$ (11,080)	$ (268,244)	
Comprehensive Income:								
Net Income	82,526	-	-	-	82,526	-	-	$ 82,526
Other Comprehensive Income, Net of Tax:								
Change in Unrealized Gains and Losses on Investment Securities Available-for-Sale	(28,386)	-	-	(28,386)	-	-	-	(28,386)
Total Comprehensive Income								$ 54,140
Share-Based Compensation	2,803	-	2,803	-	-	-	-	
Common Stock Issued under Share-Based Compensation Plans and Related Tax Benefits (537,554 shares)	19,598	1	(6,680)	-	(9,999)	11,080	25,196	
Common Stock Repurchased (1,241,303 shares)	(65,453)	-	-	-	-	-	(65,453)	
Cash Dividends Paid	(37,712)	-	-	-	(37,712)	-	-	
Balance as of June 30, 2006	$ 666,728	$ 566	$ 469,461	$ (76,204)	$ 581,406	$ -	$ (308,501)	

The accompanying notes are an integral part of the Consolidated Financial Statements (Unaudited).

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Bank of Hawaii Corporation and Subsidiaries
Consolidated Statements of Cash Flows (Unaudited)

(dollars in thousands)	**Six Months Ended June 30, 2007**	**2006**
Operating Activities		
Net Income	$ 95,064	$ 82,526
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Credit Losses	5,994	4,830
Depreciation and Amortization	7,376	8,342
Amortization of Deferred Loan and Lease Fees	(911)	(1,679)
Amortization and Accretion of Premiums/Discounts on Investment Securities, Net	1,603	2,121
Change in Fair Value of Mortgage Servicing Rights	600	-
Share-Based Compensation	2,748	2,803
Deferred Income Taxes	(35,400)	11,694
Net Gain on Investment Securities	(591)	-
Net Change in Investment Securities Trading	40,551	-
Proceeds from Sales of Loans Held for Sale	179,139	168,656
Originations of Loans Held for Sale	(180,724)	(166,247)
Tax Benefits from Shared-Based Compensation	(2,229)	(4,181)
Net Change in Other Assets and Other Liabilities	(27,139)	(21,443)
Net Cash Provided by Operating Activities	86,081	87,422
Investing Activities		
Proceeds from the Prepayment and Maturity of Investment Securities Available-for-Sale	301,327	212,464
Purchases of Investment Securities Available-for-Sale	(334,901)	(232,385)
Proceeds from the Prepayment and Maturity of Investment Securities Held-to-Maturity	43,861	47,055
Purchases of Investment Securities Held-to-Maturity	-	(20,250)
Net Change in Loans and Leases	9,239	(276,350)
Premises and Equipment, Net	(4,380)	(4,864)
Net Cash Provided by (Used in) Investing Activities	15,146	(274,330)
Financing Activities		
Net Change in Deposits	291,010	(141,435)
Net Change in Short-Term Borrowings	(102,426)	314,426
Tax Benefits from Share-Based Compensation	2,229	4,181
Proceeds from Issuance of Common Stock	12,500	15,389
Repurchase of Common Stock	(41,157)	(65,453)
Cash Dividends Paid	(40,757)	(37,712)
Net Cash Provided by Financing Activities	121,399	89,396
Net Change in Cash and Cash Equivalents	222,626	(97,512)
Cash and Cash Equivalents at Beginning of Period	453,332	498,718
Cash and Cash Equivalents at End of Period	$ 675,958	$ 401,206
Supplemental Information		
Cash paid for:		
Interest	$ 105,555	$ 72,001
Income Taxes	33,076	30,399
Non-Cash Investing and Financing Activities:		
Transfers from Investment Securities Available-for-Sale to Trading	164,180	-
Transfers from Loans to Foreclosed Real Estate	138	241

The accompanying notes are an integral part of the Consolidated Financial Statements (Unaudited).

Bank of Hawaii Corporation and Subsidiaries

Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

Bank of Hawaii Corporation (the Parent) is a bank holding company headquartered in Honolulu, Hawaii. Bank of Hawaii Corporation and its Subsidiaries (the Company) provide a broad range of financial products and services to customers in Hawaii and the Pacific Islands (Guam, nearby islands, and American Samoa). The Parent s principal subsidiary is Bank of Hawaii (the Bank). All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the consolidated financial statements reflect normal recurring adjustments necessary for a fair presentation of the results for the interim periods.

Certain prior period amounts have been reclassified to conform to current period classifications.

These statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006. Operating results for the six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Mortgage Servicing Rights

Effective January 1, 2007, the Company adopted the provisions of SFAS No. 156, *Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140.* SFAS No. 156 requires all separately recognized servicing assets and liabilities to be initially measured at fair value, if practicable. In adopting the provisions of SFAS No. 156, the Company recorded an increase in the value of mortgage servicing rights of $8.0 million and a net of tax increase to retained earnings of $5.1 million. Also, as permitted by SFAS No. 156, the Company reclassified investment securities with a carrying value of $164.2 million (Designated Securities) from the available-for-sale portfolio to the trading portfolio. Concurrently, the Company reclassified unrealized losses of $5.3 million, net of tax, previously recorded as a component of accumulated other comprehensive loss, to retained earnings. The Designated Securities are carried at fair value on the Company s statement of condition, with realized and unrealized gains and losses recorded as a component of the change in fair value of Designated Securities in mortgage banking income. The change in fair value of Designated Securities are intended to offset changes in valuation assumptions affecting the recorded value of the mortgage servicing rights. The net after-tax cumulative-effect adjustment to adopt the provisions of SFAS No. 156 was to reduce retained earnings by $0.2 million as of January 1, 2007. The Company also adopted the fair value measurement provisions of SFAS No. 156 in subsequent re-measurements of the mortgage servicing rights.

Leveraged Leases

Effective January 1, 2007, the Company adopted the provisions of FASB Staff Position (FSP) No. 13-2, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction,* which amends SFAS No. 13, *Accounting for Leases.* The timing of cash flows relating to income taxes generated by a leveraged lease is an important assumption that affects the periodic income recognized by the lessor for that lease transaction. Under the provisions of FSP No. 13-2, a change or projected change in the timing of cash flows relating to income taxes generated by a leveraged lease transaction requires a recalculation of the total and periodic income related to the leveraged lease transaction. During the years 1998 through 2002, the Company entered into one leveraged lease transaction known as a Lease In-Lease Out (LILO) transaction and five Sale In-Lease Out (SILO) transactions. As of January 1, 2007, the income tax impact of these LILO and SILO transactions was in various stages of review by the Internal Revenue Service (the IRS). Management expected that the outcome of these reviews would change the projected timing of cash flows from these leveraged leases. As a result, in adopting the provisions of FSP No. 13-2 on January 1, 2007, the Company recorded an after-tax cumulative-effect adjustment to reduce retained earnings by $27.1 million. This adjustment represented a $42.7 million reduction in the carrying value of lease financing balances and a $15.6 million reduction in deferred income taxes payable. The provisions of FSP No. 13-2 also provide that subsequent changes in the timing of projected cash flows that results in a change in the net investment of a leveraged lease is to be recorded as a gain or loss in the period in which the assumption is changed.

During the second quarter of 2007, the Company reached an agreement with the IRS as to the terms of settlement of the issues related to the Company s LILO transaction. See Note 4 for further discussion on the matter. There has been no change in the status of the IRS review of the Company s SILO transactions.

Income Taxes

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109.* FIN 48 established a recognition threshold and measurement attributes for income tax positions recognized in the Company s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes.* In evaluating a tax position for recognition, the Company judgmentally evaluates whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of related appeals or litigation processes, based on the technical merits of the position. If the tax position meets the more-likely-than-not recognition threshold, the tax position is measured and recognized in the Company s financial statements as the largest amount of tax benefit that is in management s judgment greater than 50% likely of being realized upon ultimate settlement. Effective January 1, 2007, the Company also adopted the provisions of FSP No. FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48,* which provides guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing a liability for previously unrecognized tax benefits in the statement of condition. In adopting the provisions of FIN 48 and FSP No. FIN 48-1 on January 1, 2007, the Company recorded an after-tax cumulative-effect adjustment to reduce retained earnings by $7.2 million.

See Note 4 for further discussion on the Company s FIN 48 tax positions as of January 1, 2007 and June 30, 2007.

Future Application of Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements,* which is effective for the Company on January 1, 2008. SFAS No. 157 established a framework for measuring fair value, while expanding fair value measurement disclosures. SFAS No. 157 established a fair value hierarchy that distinguishes between independent observable inputs and unobservable inputs developed based on the best information available. SFAS No. 157 expands disclosures about the use of fair value to measure assets and liabilities, the effect of these measurements on earnings for the period, and the inputs used to measure fair value. Management is currently evaluating the effect that the provisions of SFAS No. 157 will have on the Company s statements of income and condition.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115,* which is effective for the Company on January 1, 2008. SFAS No. 159 provides entities with an option to report selected financial assets and financial liabilities, on an instrument by instrument basis, at fair value, with the objective of reducing both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. Management is currently evaluating the effect that the provisions of SFAS No. 159 will have on the Company s statements of income and condition.

Note 2. Mortgage Banking

The Company s portfolio of residential mortgage loans serviced for third parties was $2.5 billion as of June 30, 2007 and 2006. The Company s mortgage servicing activities includes collecting principal, interest, and escrow payments from borrowers; making tax and insurance payments on behalf of the borrowers; monitoring delinquencies and executing foreclosure proceedings; and accounting for and remitting principal and interest payments to investors. The Company s residential mortgage loan servicing portfolio is comprised primarily of fixed rate loans concentrated in Hawaii.

Mortgage servicing rights are recognized as assets when mortgage loans are sold and the rights to service those loans are retained. As of December 31, 2006, the Company recorded its mortgage servicing rights at their relative fair values on the date the loans were sold and were carried at the lower of the initial recorded value, adjusted for amortization, or fair value. As of January 1, 2007, the Company adopted the provisions of SFAS No. 156 which requires all separately recognized servicing assets to be initially measured at fair value, if practicable. As of January 1, 2007, the Company identified its entire balance of mortgage servicing rights as one class of servicing assets for this measurement. The table below reconciles the balance of the Company s mortgage servicing rights as of December 31, 2006 and January 1, 2007.

(Unaudited) (dollars in thousands)		
Balance as of December 31, 2006	$	19,437
Cumulative-Effect of a Change in Accounting Principle	8,007	
Balance as of January 1, 2007	$	27,444

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The changes in the fair value of the Company s mortgage servicing rights for the three and six months ended June 30, 2007 were as follows:

(Unaudited) (dollars in thousands)	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007
Beginning of Period, Fair Value	$ 27,005	$ 27,444
Origination of Mortgage Servicing Rights	1,340	2,268
Change in Fair Value of Mortgage Servicing Rights:		
Due to Change in Valuation Assumptions 1	1,980	1,169
Other Changes in Fair Value 2	(1,213)	(1,769)
Total Change in Fair Value of Mortgage Servicing Rights	767	(600)
End of Period, Fair Value	$ 29,112	$ 29,112

1 Principally reflects changes in weighted-average constant prepayment rate and weighted-average life assumptions.

2 Principally represents changes due to the pay-off of loans during the period.

The Company estimates the fair value of its mortgage servicing rights by using a discounted cash flow model to calculate the present value of estimated future net servicing income. The model uses factors such as loan repayment rates, costs to service, ancillary income, impound account balances, and interest rate assumptions in its calculations. Risks inherent in the valuation of mortgage servicing rights include changes in interest rates, higher than expected loan repayment rates, and the delayed receipt of cash flows, among other factors. The key assumptions used in estimating the fair value of the Company s mortgage servicing rights as of June 30, 2007 were as follows:

(Unaudited)	As of June 30, 2007
Weighted-Average Constant Prepayment Rate 1	10.37%
Weighted-Average Life (in years)	6.24
Weighted-Average Note Rate	5.81%
Weighted-Average Discount Rate	8.57%

1 Represents annualized loan repayment rate assumption.

For the three and six months ended June 30, 2007 and 2006, the Company s mortgage banking income was comprised of the following:

Mortgage Banking Income (Unaudited)

(dollars in thousands)	Three Months Ended June 30, 2007	2006	Six Months Ended June 30, 2007	2006
Servicing Income	$ 1,559	$ 1,616	$ 3,129	$ 3,202
Gains on the Sale of Residential Mortgage Loans	1,395	1,292	2,424	2,642
Change in Fair Value of Mortgage Servicing Rights	767	-	(600)	-
Change in Fair Value of Designated Securities 1	(1,917)	-	(343)	-
Mortgage Loan Fees	676	584	1,223	1,119
Gains (Losses) on Derivative Financial Instruments	29	(171)	51	(61)
Amortization of Mortgage Servicing Rights	-	(720)	-	(1,201)
Other	(30)	(32)	(34)	(145)
Total Mortgage Banking Income	$ 2,479	$ 2,569	$ 5,850	$ 5,556

1 On-balance-sheet hedging instruments.

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For the three and six months ended June 30, 2007, the Company s entire trading portfolio, comprised of mortgage-backed securities, was designated to manage the volatility of the fair value of mortgage servicing rights as an on-balance-sheet hedge. For the three and six months ended June 30, 2007, realized investment trading gains and losses were not material.

The fair value of the Company s mortgage servicing rights is sensitive to changes in interest rates and their effect on loan repayment rates. A sensitivity analysis of the Company s fair value of mortgage servicing rights to changes in the constant prepayment rate and the discount rate is presented in the following table:

Sensitivity Analysis (Unaudited)

(dollars in thousands)	As of June 30, 2007
Constant Prepayment Rate	
Decrease in fair value from 25 basis points (bps) adverse change	$ (690)
Decrease in fair value from 50 bps adverse change	(1,624)
Discount Rate	
Decrease in fair value from 25 bps adverse change	(285)
Decrease in fair value from 50 bps adverse change	(565)

This analysis generally cannot be extrapolated because the relationship of a change in one key assumption to the change in the fair value of the Company s mortgage servicing rights usually is not linear. The calculation of the fair value of mortgage servicing rights is dynamic in nature, in that changes in one key assumption may result in changes in other assumptions, which may magnify or counteract the sensitivity analysis presented in the table above.

Note 3. Pension Plans and Postretirement Benefit Plan

The components of net periodic benefit cost for the Company s pension plans and the postretirement benefit plan for the three and six months ended June 30, 2007 and 2006 are presented in the following table:

Pension Plans and Postretirement Benefit Plan (Unaudited)

	Pension Benefits		Postretirement Benefits	
(dollars in thousands)	2007	2006	2007	2006
Three Months Ended June 30,				
Service Cost	$ -	$ -	$ 155	$ 290
Interest Cost	1,223	1,170	395	480
Expected Return on Plan Assets	(1,373)	(1,261)	-	-
Amortization of Unrecognized Net Transition Obligation	-	-	-	146
Prior Service Credit	-	-	(50)	-
Recognized Net Actuarial Loss (Gain)	450	468	(75)	(34)
Net Periodic Benefit Cost	$ 300	$ 377	$ 425	$ 882
Six Months Ended June 30,				
Service Cost	$ -	$ -	$ 310	$ 580
Interest Cost	2,446	2,340	790	960
Expected Return on Plan Assets	(2,746)	(2,522)	-	-
Amortization of Unrecognized Net Transition Obligation	-	-	-	293
Prior Service Credit	-	-	(100)	-
Recognized Net Actuarial Loss (Gain)	900	937	(150)	(70)
Net Periodic Benefit Cost	$ 600	$ 755	$ 850	$ 1,763

The net periodic benefit cost for the Company s pension plans and postretirement benefit plan are recorded as a component of salaries and benefits in the statements of income. There were no significant changes from the previously reported $7.7 million that the Company expects to contribute to the pension plans and the $1.3 million that it expects to contribute to the postretirement benefit plan for the year ending December 31, 2007. For the three and six months ended June 30, 2007, the Company contributed $4.6 million and $4.8 million, respectively, to its pension plans. For the three and six months ended June 30, 2007, the Company contributed $0.2 million and $0.5 million, respectively, to its postretirement benefit plan.

Note 4. Income Taxes

The following is a reconciliation of the statutory Federal income tax rate to the Company s effective tax rate for the three and six months ended June 30, 2007 and 2006.

	Three Months Ended June 30,		Six Months Ended June 30,	
(Unaudited)	**2007**	**2006**	**2007**	**2006**
Statutory Federal Income Tax Rate	35.00 %	35.00 %	35.00 %	35.00 %
Increase (Decrease) in Income Tax Rate Resulting From:				
State Income Tax, Net of Federal Income Tax	3.67	4.95	3.75	3.42
Foreign Tax Credits	(0.72)	-	(1.08)	-
Low Income Housing Investments	(0.14)	(0.19)	(0.15)	(0.19)
Bank-Owned Life Insurance	(0.94)	(0.63)	(0.90)	(0.67)
Leveraged Leases	(1.15)	9.55	(0.50)	5.06
Other	(0.47)	(0.14)	(0.33)	(0.15)
Effective Tax Rate	35.25 %	48.54 %	35.79 %	42.47 %

Income earned by the Company is subject to U.S. Federal taxation and to state and territorial taxation in Hawaii and Guam, respectively. Small amounts of income are subject to taxation by other states and territories as well as some foreign countries. The Company has effectively settled issues raised during income tax examinations by taxing authorities for years prior to 1998.

As noted in Note 1, the Company reached an agreement with the IRS to effectively settle the matter related to the LILO transaction in June 2007. The effective settlement with the IRS resulted in a change in the timing of projected cash flows from the LILO transaction. In January 2007, in adopting the provisions of FSP No. 13-2, the Company recalculated the total and periodic income from the LILO transaction assuming an entire disallowance of income tax deductions taken on previously filed tax returns based on a tax court case which concluded in January 2007. With the effective settlement of the LILO transaction at a disallowance percentage of less than its original estimate, the Company recalculated the total and periodic income from the LILO transaction from the inception of the lease through June 30, 2007. In the second quarter of 2007, the Company recorded a $1.5 million credit, which was comprised of a $1.1 million credit to lease financing interest income and a $0.4 million net credit to the provision for income taxes, as a result of the June 2007 change in the disallowance assumption. The Company is currently appealing issues raised by the IRS in the examination of its income tax returns filed for 1998 through 2002 related to the Company s five SILO transactions. There has been no change in the status of the IRS review of the Company s SILO transactions. The IRS is currently in the process of examining income tax returns filed for 2003 and 2004. The State of Hawaii is currently in the process of examining income tax returns filed for 2002 through 2004.

As noted in Note 1, FIN 48 established a recognition threshold and measurement attributes for income tax positions recognized in the Company s financial statements in accordance with SFAS No. 109. FIN 48 requires the Company to record a liability, referred to as an unrecognized tax benefit (UTB), for the entire amount of benefit taken in a prior or future income tax return when the Company determines that a tax position has a less than 50% likelihood of being accepted by the taxing authority. If the Company determines that the likelihood of a tax position being accepted is greater than 50%, but less than 100%, the Company records a liability for UTBs in the amount it believes will be disallowed by the taxing authority.

As of December 31, 2006, prior to adopting the provisions of FIN 48, the Company had recorded the equivalent of $116.4 million of UTBs in its statement of condition. On January 1, 2007, in adopting the provisions of FIN 48, the Company increased its liability for UTBs to $130.6 million, of which $7.2 million was recorded as a cumulative-effect adjustment to reduce retained earnings, primarily due to the accrual of interest expense. As of January 1, 2007, of the $130.6 million in the Company s liability for UTBs, $29.3 million, that if reversed, would have an impact on the Company s effective tax rate. As of June 30, 2007, there were no material changes in the Company s liability for UTBs or in the amount, that if reversed, would have an impact on the Company s effective tax rate. With respect to the Company s appeals of its five SILO transactions, it is reasonably possible that the amount of the liability for UTBs may decrease if facts and circumstances related to the IRS appeals change within the next twelve months. However, management is currently not able to estimate a range of possible change in the amount of the liability for UTBs recorded as of June 30, 2007.

The Company classifies interest and penalties, if any, related to the liability for UTBs as a component of the provision for income taxes. As of January 1, 2007, after recording the cumulative-effect adjustment to adopt the provisions of FIN 48, the Company had accrued $21.7 million for the payment of possible interest and penalties. For the three and six months ended June 30, 2007, the amount recorded by the Company as an estimate of the expected payment of interest and penalties in the provision for income taxes was not material.

Note 5. Business Segments

The Company s business segments are Retail Banking, Commercial Banking, Investment Services, and Treasury. The Company s internal management accounting process measures the performance of the business segments based on the management structure of the Company. This process, which is not necessarily comparable with similar information for any other financial institution, uses various techniques to assign balance sheet and income statement amounts to the business segments, including allocations of income, expense, the Provision, and capital. This process is dynamic and requires certain allocations based on judgment and other subjective factors. Unlike financial accounting, there is no comprehensive, authoritative guidance for management accounting that is equivalent to U.S. GAAP.

Selected financial information for each segment is presented below for the three and six months ended June 30, 2007 and 2006.

Business Segment Selected Financial Information (Unaudited)

(dollars in thousands)	Retail Banking	Commercial Banking	Investment Services	Treasury	Consolidated Total
Three Months Ended June 30, 2007					
Net Interest Income (Loss)	$ 60,126	$ 35,288	$ 4,325	$ (861)	$ 98,878
Provision for Credit Losses	2,559	813	-	(9)	3,363
Net Interest Income (Loss) After Provision for Credit Losses	57,567	34,475	4,325	(852)	95,515
Noninterest Income	27,063	7,528	19,686	3,751	58,028
Noninterest Expense	(42,717)	(19,978)	(16,251)	(886)	(79,832)
Income Before Provision for Income Taxes	41,913	22,025	7,760	2,013	73,711
Provision for Income Taxes	(15,509)	(8,231)	(2,871)	629	(25,982)
Allocated Net Income	$ 26,404	$ 13,794	$ 4,889	$ 2,642	$ 47,729
Total Assets as of June 30, 2007	$ 3,987,482	$ 2,746,074	$ 243,026	$	