BANK OF HAWAII CORP
Form 10-Q
May 02, 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 March 31, 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 April 27, 2007, there were 49,563,042 shares of common stock outstanding.

Bank of Hawaii Corporation

Form 10-Q

Index

Bank of Hawaii Corporation and Subsidiaries

Consolidated Statements of Income (Unaudited)

(dollars in thousands, except per share amounts)	Three Months Ended March 31, 2007	2006
Interest Income		
Interest and Fees on Loans and Leases	$ 110,298	$ 99,371
Income on Investment Securities		
Trading	1,618	-
Available-for-Sale	30,961	30,835
Held-to-Maturity	4,052	4,757
Deposits	58	43
Funds Sold	1,058	125
Other	333	272
Total Interest Income	148,378	135,403
Interest Expense		
Deposits	33,375	19,633
Securities Sold Under Agreements to Repurchase	11,886	7,890
Funds Purchased	923	1,893
Short-Term Borrowings	87	57
Long-Term Debt	3,970	3,728
Total Interest Expense	50,241	33,201
Net Interest Income	98,137	102,202
Provision for Credit Losses	2,631	2,761
Net Interest Income After Provision for Credit Losses	95,506	99,441
Noninterest Income		
Trust and Asset Management	15,833	14,848
Mortgage Banking	3,371	2,987
Service Charges on Deposit Accounts	10,967	10,132
Fees, Exchange, and Other Service Charges	16,061	14,767
Investment Securities Gains, Net	16	-
Insurance	6,215	5,019
Other	8,497	4,819
Total Noninterest Income	60,960	52,572
Noninterest Expense		
Salaries and Benefits	45,406	45,786
Net Occupancy	9,811	9,643
Net Equipment	4,787	5,028
Professional Fees	2,543	438
Other	19,576	19,923
Total Noninterest Expense	82,123	80,818
Income Before Provision for Income Taxes	74,343	71,195
Provision for Income Taxes	27,008	25,845
Net Income	$ 47,335	$ 45,350
Basic Earnings Per Share	$ 0.96	$ 0.89
Diluted Earnings Per Share	$ 0.94	$ 0.87
Dividends Declared Per Share	$ 0.41	$ 0.37
Basic Weighted Average Shares	49,427,810	50,813,676
Diluted Weighted Average Shares	50,263,296	52,135,386

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)	March 31, 2007	December 31, 2006	March 31, 2006
Assets			
Interest-Bearing Deposits	$ 5,594	$ 4,990	$ 5,171
Funds Sold	97,000	50,000	328,000
Investment Securities			
Trading	158,469	-	-
Available-for-Sale			
Held in Portfolio	1,672,893	1,846,742	2,268,644
Pledged as Collateral	765,639	751,135	280,560
Held-to-Maturity (Fair Value of $340,636; $360,719; and $417,938)	349,663	371,344	433,021
Loans Held for Sale	19,238	11,942	22,754
Loans and Leases	6,507,152	6,623,167	6,246,125
Allowance for Loan and Lease Losses	(90,998)	(90,998)	(91,064)
Net Loans and Leases	6,416,154	6,532,169	6,155,061
Total Earning Assets	9,484,650	9,568,322	9,493,211
Cash and Noninterest-Bearing Deposits	365,517	398,342	422,436
Premises and Equipment	123,309	125,925	143,392
Customers Acceptances	839	1,230	729
Accrued Interest Receivable	49,477	49,284	44,149
Foreclosed Real Estate	462	407	358
Mortgage Servicing Rights	27,005	19,437	18,468
Goodwill	34,959	34,959	34,959
Other Assets	405,739	373,909	370,347
Total Assets	$ 10,491,957	$ 10,571,815	$ 10,528,049
Liabilities			
Deposits			
Noninterest-Bearing Demand	$ 1,973,631	$ 1,993,794	$ 2,377,355
Interest-Bearing Demand	1,618,615	1,642,375	1,674,294
Savings	2,648,495	2,690,846	2,716,572
Time	1,712,196	1,696,379	1,378,880
Total Deposits	7,952,937	8,023,394	8,147,101
Funds Purchased	72,400	60,140	55,930
Short-Term Borrowings	3,462	11,058	2,025
Securities Sold Under Agreements to Repurchase	1,050,393	1,047,824	957,166
Long-Term Debt	260,308	260,288	242,730
Banker s Acceptances	839	1,230	729
Retirement Benefits Payable	48,363	48,309	71,708
Accrued Interest Payable	17,893	22,718	11,882
Taxes Payable and Deferred Taxes	293,326	277,202	273,088
Other Liabilities	81,005	100,232	84,612
Total Liabilities	9,780,926	9,852,395	9,846,971
Shareholders Equity			
Common Stock ($.01 par value; authorized 500,000,000 shares; issued / outstanding: March 2007 - 56,930,753 / 49,638,731; December 2006 - 56,848,609 / 49,777,654; and March 2006 - 56,858,558 / 50,970,829)	566	566	566
Capital Surplus	478,123	475,178	467,678
Accumulated Other Comprehensive Loss	(27,356)	(39,084)	(65,668)
Retained Earnings	620,034	630,660	565,702
Treasury Stock, at Cost (Shares: March 2007 - 7,292,022; December 2006 - 7,070,955; and March 2006 - 5,887,729)	(360,336)	(347,900)	(287,200)
Total Shareholders Equity	711,031	719,420	681,078
Total Liabilities and Shareholders Equity	$ 10,491,957	$ 10,571,815	$ 10,528,049

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

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	47,335	-	-	-	47,335	-	-	$ 47,335
Other Comprehensive Income, Net of Tax:								
Change in Unrealized Gains and Losses on Investment Securities Available-for-Sale	6,241	-	-	6,241	-	-	-	6,241
Amortization of Prior Service Credit and Net Actuarial Loss	208	-	-	208	-	-	-	208
Total Comprehensive Income								$ 53,784
Common Stock Issued under Share-Based Compensation Plans and Related Tax Benefits (255,918 shares)	8,160	-	2,945	-	(3,044)	-	8,259	
Common Stock Repurchased (394,247 shares)	(20,695)	-	-	-	-	-	(20,695)	
Cash Dividends Paid	(20,411)	-	-	-	(20,411)	-	-	
Balance as of March 31, 2007	$ 711,031	$ 566	$ 478,123	$ (27,356)	$ 620,034	$ -	$ (360,336)	
Balance as of December 31, 2005	$ 693,352	$ 565	$ 473,338	$ (47,818)	$ 546,591	$ (11,080)	$ (268,244)	
Comprehensive Income:								
Net Income	45,350	-	-	-	45,350	-	-	$ 45,350
Other Comprehensive Income, Net of Tax:								
Change in Unrealized Gains and Losses on Investment Securities Available-for-Sale	(17,850)	-	-	(17,850)	-	-	-	(17,850)
Total Comprehensive Income								$ 27,500
Common Stock Issued under Share-Based Compensation Plans and Related Tax Benefits (393,036 shares)	16,014	1	(5,660)	-	(7,299)	11,080	17,892	
Common Stock Repurchased (697,974 shares)	(36,848)	-	-	-	-	-	(36,848)	
Cash Dividends Paid	(18,940)	-	-	-	(18,940)	-	-	
Balance as of March 31, 2006	$ 681,078	$ 566	$ 467,678	$ (65,668)	$ 565,702	$ -	$ (287,200)	

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

Bank of Hawaii Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Unaudited)

(dollars in thousands)	Three Months Ended March 31, 2007	2006
Operating Activities		
Net Income	$ 47,335	$ 45,350
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Credit Losses	2,631	2,761
Depreciation and Amortization	3,695	4,317
Amortization of Deferred Loan and Lease Fees	(384)	(952)
Amortization and Accretion of Premiums/Discounts on Investment Securities, Net	806	1,060
Change in Fair Value of Mortgage Servicing Rights	1,367	-
Investment Trading Gains	(1,574)	-
Share-Based Compensation	1,335	1,355
Deferred Income Taxes	(34,226)	3,359
Net Gain on Investment Securities	(16)	-
Proceeds from the Prepayment of Investment Securities Trading	7,285	-
Proceeds from Sales of Loans Held for Sale	72,793	80,948
Originations of Loans Held for Sale	(80,089)	(85,787)
Tax Benefits from Share-Based Compensation	(1,512)	(3,932)
Net Change in Other Assets and Liabilities	(11,244)	(6,314)
Net Cash Provided by Operating Activities	8,202	42,165
Investing Activities		
Proceeds from the Prepayment and Maturity of Investment Securities Available-for-Sale	157,784	100,326
Purchases of Investment Securities Available-for-Sale	(145,196)	(139,998)
Proceeds from the Prepayment and Maturity of Investment Securities Held-to-Maturity	21,485	20,956
Net Decrease (Increase) in Loans and Leases	71,049	(79,450)
Premises and Equipment, Net	(1,079)	(13,796)
Net Cash Provided by (Used In) Investing Activities	104,043	(111,962)
Financing Activities		
Net (Decrease) Increase in Deposits	(70,457)	239,633
Net Increase in Short-Term Borrowings	7,233	128,184
Tax Benefits from Share-Based Compensation	1,512	3,932
Proceeds from Issuance of Common Stock	5,352	10,725
Repurchase of Common Stock	(20,695)	(36,848)
Cash Dividends Paid	(20,411)	(18,940)
Net Cash (Used In) Provided by Financing Activities	(97,466)	326,686
Net Increase in Cash and Cash Equivalents	14,779	256,889
Cash and Cash Equivalents at Beginning of Period	453,332	498,718
Cash and Cash Equivalents at End of Period	$ 468,111	$ 755,607
Supplemental Information		
Cash paid for:		
Interest	$ 55,066	$ 32,229
Income taxes	3,489	4,364
Non-cash investing and financing activities:		
Transfers from investment securities available-for-sale to trading	164,180	-
Transfers from loans to foreclosed real estate	462	359

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 three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

Hybrid Financial Instruments

Effective January 1, 2007, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140.* SFAS No. 155 permits, but does not require, fair value accounting for hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities.* Concurrently, the Company adopted the provisions of SFAS No. 133, Implementation Issue No. B40, *Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets.* In Implementation Issue No. B40, the Financial Accounting Standards Board (the FASB) concluded that a securitized interest in prepayable financial assets would not be subject to the bifurcation requirements of SFAS No. 155, provided that the securitized interest met certain criteria. The adoption of SFAS No. 155 and SFAS No. 133, Implementation Issue No. B40 did not have a material impact on the Company s statements of income and condition.

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 in 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 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 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.

For the three months ended March 31, 2007, the Company s entire trading portfolio, comprised of mortgage-backed securities, was used to offset changes in the fair value of the mortgage servicing rights. These trading 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 mortgage banking income in the statement of income.

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.* Under the provisions of FSP No. 13-2, a material revision in the timing of expected cash flows of a leveraged lease requires a recalculation of the original lease assumptions. During the years 1998 through 2002, the Company entered into one leveraged lease transaction known as a Lease In/Lease Out transaction and five Sale In/Lease Out transactions that are currently under various stages of review by the Internal Revenue Service (the IRS). Management expects that the outcome of these reviews will change the expected timing of cash flows from these leases. In adopting the provisions of FSP No. 13-2, the Company recorded an after-tax cumulative-effect adjustment to reduce retained earnings by $27.1 million. This adjustment represents a $42.7 million reduction of the carrying value of lease financing balances and a reduction of deferred income taxes of $15.6 million. Subsequent changes in the assumption of expected cash flows that results in a material change in the net investment of a leveraged lease will be recorded as a gain or loss in the period in which the assumption is changed.

Income Taxes

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109.* FIN 48 establishes a recognition threshold and measurement 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 greater than 50% likely of being realized upon ultimate resolution. In adopting the provisions of FIN 48, the Company recorded an after-tax cumulative-effect adjustment to reduce retained earnings by $7.2 million.

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 valuations obtained from sources independent of the Company and those from the Company s own unobservable inputs that are not corroborated by observable market data. SFAS No. 157 also expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. The disclosures focus on the inputs used to measure fair value and for recurring fair value measurements using significant unobservable inputs, and the effect of the measurements on earnings for the period. 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 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

For the three months ended March 31, 2007 and 2006, the Company s mortgage banking income was comprised of the following:

Mortgage Banking Income (Unaudited)

	Three Months Ended March 31,	
(dollars in thousands)	**2007**	**2006**
Servicing Income	$ 1,570	$ 1,586
Gains on the Sale of Residential Mortgage Loans	1,029	1,351
Change in Fair Value of Mortgage Servicing Rights	(1,367)	-
Investment Trading Gains	1,574	-
Mortgage Loan Fees	548	535
Gains on Derivative Financial Instruments	22	110
Amortization of Mortgage Servicing Rights	-	(481)
Other	(5)	(114)
Total Mortgage Banking Income	$ 3,371	$ 2,987

The Company s portfolio of residential mortgage loans serviced for third parties was $2.5 billion as of March 31, 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 in mortgage servicing rights as one class of servicing assets for this measurement. The changes in the value of the Company s mortgage servicing rights for the three months ended March 31, 2007 were as follows:

Mortgage Servicing Rights (Unaudited)

(dollars in thousands)		**Three Months Ended March 31, 2007**
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
Origination of Mortgage Servicing Rights	928	
Changes in Fair Value:		
Due to Change in Valuation Assumptions1	(574	)
Other Changes in Fair Value2	(793	)
Balance as of March 31, 2007	$	27,005

1 Principally reflects changes in discount rates and loan repayment rate assumptions, mostly as a result of changes in interest rates.