CPI INTERNATIONAL, INC.
Form 10-Q
February 12, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 December 29, 2006

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: 000-51928

CPI INTERNATIONAL, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

75-3142681

(I.R.S. Employer Identification No.)

811 Hansen Way
Palo Alto, California 94303-1110
(650) 846-2900

(Address of Principal Executive Offices and 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 o Accelerated filer o Non-accelerated filer x

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding for each of the registrant s classes of Common Stock, as of the latest practicable date: 16,261,173 shares of Common Stock, $.01 par value, at January 31, 2007.

CPI INTERNATIONAL, INC.

and subsidiaries

INDEX

Part I: Financial Information		
Item 1.	Financial Statements	
	Unaudited Condensed Consolidated Balance Sheets	4
	Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income	5
	Unaudited Condensed Consolidated Statements of Cash Flows	6
	Notes to Unaudited Condensed Consolidated Financial Statements	7
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	30
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	42
Item 4.	Controls and Procedures	43
Part II: Other Information		
Item 1.	Legal Proceedings	44
Item 1A.	Risk Factors	44
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	44
Item 3.	Defaults Upon Senior Securities	44
Item 4.	Submission of Matters to a Vote of Security Holders	44
Item 5.	Other Information	44
Item 6.	Exhibits	44

CPI INTERNATIONAL, INC.

and subsidiaries

Cautionary Statements Regarding Forward-Looking Statements

This document contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that relate to future events or our future financial performance. In some cases, readers can identify forward-looking statements by terminology such as may, will, should, expect, plan, anticipate, believe, estimate, pred continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. Forward-looking statements are subject to known and unknown risks and uncertainties, which could cause actual results to differ materially from the results projected, expected or implied by the forward-looking statements. These risk factors include, without limitation, competition in our end markets; our significant amount of debt; changes or reductions in the U.S. defense budget; U.S. government contracts laws and regulations; changes in technology; the impact of unexpected costs; inability to obtain raw materials and components; and currency fluctuations. All written and oral forward-looking statements made in connection with this report that are attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing risk factors and other cautionary statements included herein and in our other filings with the Securities and Exchange Commission (SEC). We are under no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

The information in this report is not a complete description of our business or the risks and uncertainties associated with an investment in our securities. You should carefully consider the various risks and uncertainties that impact our business and the other information in this report and in our other filings with the SEC before you decide to invest in our securities or to maintain or increase your investment.

CPI INTERNATIONAL, INC.

and subsidiaries

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data unaudited)

	December 29, 2006	September 29, 2006
Assets		
Current Assets:		
Cash and cash equivalents	$ 32,629	$ 30,153
Restricted cash	1,951	1,746
Accounts receivable, net	40,744	43,628
Inventories	54,640	54,031
Deferred tax assets	11,884	11,520
Prepaid and other current assets	3,260	3,080
Total current assets	145,108	144,158
Property, plant, and equipment, net	65,120	63,851
Deferred debt issue costs, net	9,285	9,644
Intangible assets, net	74,878	75,489
Goodwill	147,459	147,489
Other long-term assets	976	1,128
Total assets	$ 442,826	$ 441,759
Liabilities and stockholders equity		
Current Liabilities:		
Current portion of long-term debt	$	$ 1,714
Accounts payable	15,707	19,101
Accrued expenses	27,936	23,269
Product warranty	5,842	5,958
Income taxes payable	9,105	10,693
Advance payments from customers	6,824	6,310
Total current liabilities	65,414	67,045
Deferred income taxes	29,977	29,933
Long-term debt, less current portion	241,794	245,067
Other long-term liabilities	51	41
Total liabilities	337,236	342,086
Commitments and contingencies		
Stockholders equity		
Common stock ($0.01 par value, 90,000,000 shares authorized; 16,086,445 and 16,049,577 shares issued and outstanding)	161	160
Additional paid-in capital	65,765	65,295
Accumulated other comprehensive income	290	679
Retained earnings	39,374	33,539
Total stockholders equity	105,590	99,673
Total liabilities and stockholders equity	$ 442,826	$ 441,759

See accompanying notes to the condensed consolidated financial statements.

CPI INTERNATIONAL, INC.

and subsidiaries

CONDENSED CONSOLIDATED
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(in thousands, except share and per share data unaudited)

	Quarter Ended December 29, 2006	December 30, 2005
Sales	$ 83,723	$ 82,379
Cost of sales	57,142	57,171
Gross profit	26,581	25,208
Operating costs and expenses:		
Research and development	1,891	1,910
Selling and marketing	4,829	5,024
General and administrative	4,404	7,302
Amortization of acquisition-related intangible assets	548	548
Net loss on disposition of fixed assets	18	65
Total operating costs and expenses	11,690	14,849
Operating income	14,891	10,359
Interest expense, net	5,339	6,064
Income before income taxes	9,552	4,295
Income tax expense	3,717	2,080
Net income	$ 5,835	$ 2,215
Other comprehensive income, net of tax Net unrealized loss on cash flow hedges	(389)	(183)
Comprehensive income	$ 5,446	$ 2,032
Earnings per share - Basic	$ 0.36	$ 0.17
Earnings per share - Diluted	$ 0.33	$ 0.15
Shares used to compute earnings per share - Basic	16,063,221	13,078,954
Shares used to compute earnings per share - Diluted	17,544,363	14,768,082

See accompanying notes to the condensed consolidated financial statements.

5

CPI INTERNATIONAL, INC.

and subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands unaudited)

	Quarter Ended December 29, 2006	December 30, 2005
Cash flows from operating activities		
Net cash provided by operating activities	$ 10,042	$ 198
Cash flows from investing activities		
Expenses relating to sale of San Carlos property		(3)
Capital expenditures	(2,871)	(2,945)
Net cash used in investing activities	(2,871)	(2,948)
Cash flows from financing activities		
Proceeds from issuance of debt		10,000
Repayments of debt	(5,000)	
Proceeds from issuance of common stock to employees	197	
Proceeds from exercise of stock options	66	
Stockholder distribution payments		(17,000)
Excess tax benefit on stock option exercises	42	
Net cash used in financing activities	(4,695)	(7,000)
Net increase (decrease) in cash and cash equivalents	2,476	(9,750)
Cash and cash equivalents at beginning of period	30,153	26,511
Cash and cash equivalents at end of period	$ 32,629	$ 16,761
Supplemental cash flow disclosures		
Cash paid for interest	$ 961	$ 1,810
Cash paid for taxes, net of refunds	$ 5,150	$ 2,554

See accompanying notes to the condensed consolidated financial statements.

6

CPI INTERNATIONAL, INC.

and subsidiaries

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All tabular dollar amounts in thousands except share and per share amounts)

1. Organization and Basis of Presentation

Unless the context otherwise requires, CPI International means CPI International, Inc., and CPI means Communications & Power Industries, Inc. CPI is a direct subsidiary of CPI International. CPI International is a holding company with no operations of its own. The term the Company refers to CPI International and its subsidiaries on a consolidated basis.

The accompanying condensed consolidated financial statements represent the consolidated results and financial position of CPI International, which is controlled by affiliates of The Cypress Group (Cypress). CPI International, through its wholly owned subsidiary, CPI, develops, manufactures, and distributes microwave and power grid Vacuum Electron Devices (VEDs), microwave amplifiers, modulators and various other power supply equipment and devices. The Company has two reportable segments, VED and satcom equipment.

The condensed consolidated financial statements include those of the Company and its subsidiaries. Significant intercompany balances, transactions, and stockholdings have been eliminated in consolidation.

The Company s fiscal year is the 52- or 53-week period that ends on the Friday nearest September 30. Fiscal year 2007 comprises the 52-week period ending September 28, 2007 and fiscal year 2006 comprised the 52-week period ended September 29, 2006. All period references are to the Company s fiscal periods unless otherwise indicated. These interim financial statements should be read in conjunction with the condensed consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended September 29, 2006.

On May 3, 2006, the Company completed the initial public offering of its common stock (see Note 4 for further disclosure).

2. Supplemental Balance Sheet Information

Accounts Receivable: Accounts receivable are stated net of allowances for doubtful accounts of $0.2 million and $0.5 million at December 29, 2006 and September 29, 2006, respectively.

Inventories: The following table provides details of inventories, net of reserves:

	December 29, 2006	**September 29, 2006**
Raw material and parts	$ 34,427	$ 35,160
Work in process	12,418	10,481
Finished goods	7,795	8,390
	$ 54,640	$ 54,031

7

Reserve for excess, slow moving and obsolete inventory: The following table summarizes the activity related to reserves for excess, slow moving and obsolete inventory during the first quarter of fiscal years 2007 and 2006:

	Quarter Ended December 29, 2006	December 30, 2005
Balance at beginning of period	$ 8,822	$ 8,655
Inventory provision, charged to cost of sales	307	316
Inventory write-offs	(60)	(28)
Balance at end of period	$ 9,069	$ 8,943

Reserve for loss contracts and cost in excess of market inventory: The following table summarizes the activity related to reserves for loss contracts and cost in excess of market inventory during first quarter of fiscal years 2007 and 2006:

	Quarter Ended December 29, 2006	December 30, 2005
Balance at beginning of period	$ 1,702	$ 1,430
Provision for loss contracts and cost in excess of market inventory, charged to cost of sales	32	306
Credit to cost of sales upon revenue recognition	(101)	(222)
Balance at end of period	$ 1,633	$ 1,514

Product Warranty: The following table summarizes the activity related to product warranty during the first quarter of fiscal years 2007 and 2006:

	Quarter Ended December 29, 2006	December 30, 2005
Beginning accrued warranty	$ 5,958	$ 6,359
Accruals for product warranty, charged to cost of sales	1,211	1,048
Cost of warranty claims	(1,327)	(1,217)
Ending accrued warranty	$ 5,842	$ 6,190

Intangible Assets: The following tables present the details of the Company s total acquisition-related intangible assets:

	December 29, 2006			September 29, 2006		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
VED Core Technology	$ 30,700	$ (1,813)	$ 28,887	$ 30,700	$ (1,659)	$ 29,041
VED Application Technology	19,800	(2,328)	17,472	19,800	(2,130)	17,670
X-ray Generator and Satcom ApplicationTechnology	8,000	(1,574)	6,426	8,000	(1,441)	6,559
Customer backlog	17,450	(17,450)		17,450	(17,450)	
Land lease	11,810	(769)	11,041	11,810	(706)	11,104
Tradename	5,800		5,800	5,800		5,800
Customer list and programs	5,700	(508)	5,192	5,700	(451)	5,249
Noncompete agreement	110	(50)	60	110	(44)	66
	$ 99,370	$ (24,492)	$ 74,878	$ 99,370	$ (23,881)	$ 75,489

The estimated future amortization expense of purchased intangibles as of December 29, 2006, excluding the Company s unamortized tradename, is as follows:

Fiscal Year	Amount
2007 (remaining nine months)	1,831
2008	2,441
2009	2,441
2010	2,419
2011	2,419
Thereafter	57,527
	$ 69,078

Goodwill: The following table presents goodwill by reportable segment at December 29, 2006 and September 29, 2006:

	December 29, 2006	September 29, 2006
VED	$ 133,607	$ 133,637
Satcom Equipment	13,852	13,852
	$ 147,459	$ 147,489

The decrease in goodwill from September 29, 2006 to December 29, 2006 was due to an adjustment for tax benefits realized from the exercise of fully vested stock options that were acquired in a business combination.

9

3. Long-Term Debt

Long-term debt comprises the following:

	December 29, 2006	September 29, 2006
Term loan, expiring 2010	$ 37,500	$ 42,500
8% Senior subordinated notes, due 2012	125,000	125,000
Floating rate senior notes, due 2015, net of issue discount of $706 and $719	79,294	79,281
	241,794	246,781
Less: Current portion		1,714
Long-term portion	$ 241,794	$ 245,067

Senior Credit Facility and Term Loan of CPI: In fiscal year 2004, CPI entered into a $130.0 million credit agreement, which was amended and restated on November 29, 2004, and further amended on February 16, 2005, April 13, 2005, and December 15, 2005 (the Senior Credit Facility). The Senior Credit Facility consists of a $40.0 million revolving commitment, with a sub-facility of $15.0 million for letters of credit and $5.0 million for swingline loans (Revolver), which expires on January 23, 2010, and a $90.0 million term loan (Term Loan), which expires on July 23, 2010. As of December 29, 2006, the Company had no outstanding borrowings under the Revolver and $37.5 million outstanding under the Term Loan, after taking into account a $5.0 million Term Loan repayment in December 2006 using available operating cash. The $5.0 million Term Loan repayment included a $1.7 million ECF (as defined below) payment, and an optional prepayment of $3.3 million. In December 2005, CPI borrowed $10.0 million on the Term Loan to pay a dividend to CPI International. CPI International used the proceeds of that dividend to pay a portion of the special cash dividend of $17.0 million to its stockholders. Upon certain specified conditions, including compliance on a pro forma basis with the covenants in the Senior Credit Facility, CPI may seek commitments for a new class of term loans, not to exceed $65.0 million. The Senior Credit Facility is guaranteed by CPI International and all of CPI s domestic subsidiaries and is secured by substantially all of their assets.

Any borrowings under the Revolver would currently bear interest at a rate equal to, at CPI s option, LIBOR plus 2.75% per annum, or the Alternate Base Rate (ABR) plus 1.75% per annum. Available borrowings under the Revolver are reduced by any amounts secured through letters of credit; at December 29, 2006, the Company had letters of credit commitments for $3.8 million. The Term Loan borrowings currently bear interest at a rate equal to, at CPI s option, LIBOR plus 2.25% per annum or the ABR plus 1.25% per annum, payable quarterly. The ABR is the greater of (a) the Prime Rate and (b) the Federal Funds Rate plus 0.50%. In addition to customary fronting and administrative fees under the Senior Credit Facility, CPI pays letter of credit participation fees equal to the applicable Revolver LIBOR margin per annum on the average daily amount of the letter of credit exposure, and a commitment fee of 0.50% per annum on the average daily unused amount of revolving commitment. As of December 29, 2006 (1) the Term Loan borrowing consisted of one tranche of $5.5 million and one tranche of $32.0 million with interest payable on January 11, 2007 and January 22, 2007, each at 7.6% per annum, and (2) a Revolving commitment of $3.8 million for letter of credit exposure, with letter of credit participation fees and fronting fees payable quarterly at a combined interest rate of 3.0% per annum.

10

The Senior Credit Facility requires 1.0% of the original Term Loan amount to be repaid annually in quarterly installments of 0.25% beginning June 30, 2004 and continuing for five years, with the remainder due in equal quarterly installments thereafter. CPI is required to prepay its outstanding loans, subject to certain exceptions and limitations, with net cash proceeds received from certain events, including, without limitation (1) all such proceeds received from certain asset sales by CPI International, CPI or any of CPI s subsidiaries, (2) all such proceeds received from issuances of debt (other than certain specified permitted debt) or preferred stock by CPI International, CPI or any of CPI s subsidiaries, (3) all such proceeds paid to CPI International, CPI or any of CPI s subsidiaries from casualty and condemnation events in excess of amounts applied to replace, restore or reinvest in any properties for which proceeds were paid within a specified period and (4) 50% of such proceeds received from issuances of common equity by, or equity contributions to, CPI International.

CPI is also required to make an annual prepayment within 90 days after the end of each fiscal year based on a calculation of Excess Cash Flow, as defined in the Senior Credit Facility (ECF), multiplied by a factor of 25%, 50% or 75% depending on the leverage ratio at the end of the fiscal year, less optional prepayments made during the fiscal year. On December 30, 2004, CPI made an ECF payment of $3.9 million. The ECF payment was applied pro rata, in accordance with the provisions of the Senior Credit Facility, against the remaining scheduled installments of Term Loan principal due up to, but not including, the September 30, 2009 scheduled principal installment. The Company made an ECF payment of $1.7 million for the fiscal year ended September 29, 2006 in December 2006 and there is no expected ECF payment due for fiscal year 2007, primarily because of the $3.3 million optional prepayment that was made in December 2006.

CPI can make optional prepayments on the outstanding loans at any time without premium or penalty, except for customary breakage costs with respect to LIBOR loans. In March 2005, CPI made an optional prepayment of $5.7 million; in May 2006, CPI made additional optional prepayments of $47.5 million in the aggregate using proceeds from the initial public offering of CPI International s common stock (the IPO); and in December 2006, CPI made an additional prepayment of $3.3 million. The optional prepayments were applied pro rata, in accordance with the provisions of the Senior Credit Facility, against the remaining scheduled installments of Term Loan principal due up to June 30, 2009, with the balance applied to scheduled installment amounts on or after September 30, 2009, in direct order of maturity.

The Senior Credit Facility contains a number of covenants that, among other things, restrict, subject to certain exceptions, the ability of CPI International, CPI and CPI s domestic subsidiaries to: sell assets; engage in mergers and acquisitions; pay dividends and distributions or repurchase their capital stock; incur additional indebtedness or issue equity interests; make investments and loans; create liens or further negative pledges on assets; engage in certain transactions with affiliates; enter into sale and leaseback transactions; amend agreements or make prepayments relating to subordinated indebtedness; and amend or waive provisions of charter documents in a manner materially adverse to the lenders. CPI and CPI s subsidiaries must comply with: a minimum interest coverage ratio; a maximum total leverage ratio; a minimum fixed charge coverage ratio; and a maximum capital expenditures limitation, each calculated on a consolidated basis for CPI and CPI s subsidiaries. CPI International must also comply with a minimum interest coverage ratio, a minimum fixed charge coverage ratio and a maximum leverage ratio, each calculated on a consolidated basis for CPI International and its subsidiaries. As of December 29, 2006, CPI and CPI International were in compliance with all Senior Credit Facility financial covenants.

Subject in certain cases to applicable notice provisions and grace periods, events of default under the Senior Credit Facility include, among other things: failure to make payments when due; breaches of representations and warranties in the documents governing the Senior Credit Facility; non-compliance by CPI International, CPI and/or CPI s subsidiaries with certain covenants; failure by CPI International, CPI and/or CPI s subsidiaries to pay certain other indebtedness or to observe any other covenants or agreements that would allow acceleration of such indebtedness, collectively in excess of $5.0 million at any time; events of bankruptcy or insolvency of CPI International, CPI and/or CPI s subsidiaries; certain uninsured and unstayed judgments of $5.0 million or more against CPI International; impairment of the security interests in the collateral or the guarantees under the Senior Credit Facility; and a change in control, as defined in the documents governing the Senior Credit Facility.

8% Senior subordinated notes of CPI: In connection with a business combination on January 23, 2004, CPI issued $125.0 million in aggregate principal amount of its 8% Senior Subordinated Notes (the 8% Notes). The 8% Notes have no sinking fund requirements.

The 8% Notes bear interest at the rate of 8.0% per year, payable on February 1 and August 1 of each year. The 8% Notes will mature on February 1, 2012. The 8% Notes are unsecured obligations, jointly and severally guaranteed by CPI International and each of CPI s domestic subsidiaries. The payment of all obligations relating to the 8% Notes are subordinated in right of payment to the prior payment in full in cash or cash equivalents of all senior debt (as defined in the indenture governing the 8% Notes) of CPI, including debt under the Senior Credit Facility. Each guarantee of the 8% Notes is and will be subordinated to guarantor senior debt (as defined in the indenture governing the 8% Notes) on the same basis as the 8% Notes are subordinated to CPI s senior debt.

At any time or from time to time on or after February 1, 2008, CPI, at its option, may redeem the 8% Notes, in whole or in part, at the redemption prices (expressed as percentages of principal amount) set forth below, together with accrued and unpaid interest thereon, if any, to the redemption date, if redeemed during the 12-month period beginning on February 1 of the years indicated below:

Year	Optional Redemption Price	
2008	104	%
2009	102	%
2010 and thereafter	100	%

At any time on or prior to February 1, 2008, the 8% Notes may also be redeemed or purchased (by CPI or any other person) in whole but not in part, at CPI s option, upon the occurrence of a change of control (as defined in the indenture governing the 8% Notes) at a price equal to 100% of the principal amount of the 8% Notes, plus a make-whole premium (as defined in the indenture governing the 8% Notes) to the redemption price on February 1, 2008, and accrued and unpaid interest, if any, to, the date of redemption or purchase. Upon a change of control, CPI may be required to purchase all or any part of the 8% Notes for a cash price equal to 101% of the principal amount, plus accrued and unpaid interest thereon, if any, to the date of purchase.

12

The indenture governing the 8% Notes contains a number of covenants that, among other things, restrict, subject to certain exceptions, the ability of CPI and its restricted subsidiaries (as defined in the indenture governing the 8% Notes) to incur additional indebtedness, sell assets, consolidate or merge with or into other companies, pay dividends or repurchase or redeem capital stock or subordinated indebtedness, make certain investments, issue capital stock of their subsidiaries, incur liens and enter into certain types of transactions with their affiliates.

Events of default under the indenture governing the 8% Notes include: failure to make payments on the 8% Notes when due; failure to comply with covenants in the indenture governing the 8% Notes; a default under certain other indebtedness of CPI or any of its restricted subsidiaries that is caused by a failure to make payments on such indebtedness or that results in the acceleration of the maturity of such indebtedness; the existence of certain final judgments or orders against CPI or any of the restricted subsidiaries; and the occurrence of certain insolvency or bankruptcy events.

Floating rate senior notes of CPI International: On February 22, 2005, CPI International issued $80.0 million in principal amount of its Floating Rate Senior Notes (FR Notes). The FR Notes were issued at a 1% discount. The proceeds from the issuance of FR Notes were used to make a distribution to stockholders of CPI International of approximately $75.8 million and to pay fees and expenses of approximately $3.5 million associated with the issuance of FR Notes. The FR Notes have no sinking fund requirements.

The FR Notes require interest payments at an annual interest rate, reset at the beginning of each semi-annual period, equal to the then six-month LIBOR plus 5.75%, payable semiannually on February 1 and August 1 of each year. The interest rate on the semi-annual interest payment due February 1, 2007 is approximately 11.30% per annum. CPI International may, at its option, elect to pay interest through the issuance of additional FR Notes for any interest payment date on or before February 1, 2010. If CPI International elects to pay interest through the issuance of additional FR Notes, the annual interest rate on the FR Notes will increase by an additional 1% step-up, with the step-up increasing by an additional 1% for each interest payment made through the issuance of additional FR Notes (up to a maximum of 4%). The FR Notes will mature on February 1, 2015.

The FR Notes are general unsecured obligations of CPI International. The FR Notes are not guaranteed by any of CPI International s subsidiaries but are structurally subordinated to all existing and future indebtedness and other liabilities of CPI International s subsidiaries. The FR Notes are senior in right of payment to CPI International s existing and future indebtedness that is expressly subordinated to the FR Notes.

Because CPI International is a holding company with no operations of its own, CPI International relies on distributions from CPI to satisfy its obligations under the FR Notes. The Senior Credit Facility and the indenture governing the 8% Notes restrict CPI s ability to make distributions to CPI International. The Senior Credit Facility prohibits CPI from making distributions to CPI International unless there is no default under the Senior Credit Facility and CPI International and CPI satisfy certain leverage ratios. The indenture governing the 8% Notes prohibits CPI from making distributions to CPI International unless, among other things, there is no default under the indenture and the amount of the proposed dividend plus all previous Restricted Payments (as defined in the indenture governing the 8% Notes) does not exceed a specified amount.

At any time or from time to time CPI International, at its option, may redeem the Notes in whole or in part at the redemption prices (expressed as percentages of principal amount) set forth below, together with accrued and unpaid interest thereon, if any, to the redemption date, if redeemed during the 12-month period beginning on February 1 of the years indicated below:

Year	Optional Redemption Price	
2007	103	%
2008	102	%
2009	101	%
2010 and thereafter	100	%

Upon a change of control, as defined in the indenture governing the FR Notes, CPI International may be required to purchase all or any part of the outstanding FR Notes for a cash price equal to 101% of the principal amount, plus accrued and unpaid interest thereon, if any, to the date of purchase.

The indenture governing the FR Notes contains certain covenants that, among other things, limit the ability of CPI International and its restricted subsidiaries (as defined in the indenture governing the FR Notes) to incur additional indebtedness, sell assets, consolidate or merge with or into other companies, pay dividends or repurchase or redeem capital stock or subordinated indebtedness, make certain investments, issue capital stock of their subsidiaries, incur liens and enter into certain types of transactions with their affiliates.

Events of default under the indenture governing the FR Notes include: failure to make payments on the FR Notes when due; failure to comply with covenants in the indenture governing the FR Notes; a default under certain other indebtedness of CPI International or any of its restricted subsidiaries that is caused by a failure to make payments on such indebtedness or that results in the acceleration of the maturity of such indebtedness; the existence of certain final judgments or orders against CPI International or any of the restricted subsidiaries; and the occurrence of certain insolvency or bankruptcy events.

Debt Maturities: As of December 29, 2006, maturities on long-term debt were as follows:

Fiscal Year	Term Loan	Floating Rate Senior Notes	8% Senior Subordinated Notes	Total
2007	$	$	$	$
2008				
2009				
2010	37,500			37,500
2011				
Thereafter		80,000	125,000	205,000
	$ 37,500	$ 80,000	$ 125,000	$ 242,500

14

4. Stockholders Equity

Common and Preferred Stock: On April 7, 2006, the Company amended and restated its certificate of incorporation to provide for 90,000,000 authorized shares of Common Stock, par value $0.01 per share, and 10,000,000 authorized shares of Preferred Stock, par value $0.01 per share. The holder of each share of Common Stock has the right to one vote. The board of directors has the authority to issue the undesignated Preferred Stock in one or more series and to fix the rights, preferences, privileges and restrictions thereof. As of December 29, 2006 and September 29, 2006, there were no shares of Preferred Stock outstanding.

On April 7, 2006, in connection with the amendment and restatement of its certificate of incorporation, the Company also effected a 3.059-to-1 stock split of its outstanding shares of common stock as of such date. All share and per share amounts in the accompanying condensed consolidated financial statements and accompanying notes have been retroactively restated to reflect this stock split.

On May 3, 2006, the Company completed the IPO of its common stock. The Company sold 2,941,200 shares of common stock and the selling stockholders sold 4,117,670 shares, at an initial public offering price to the public of $18.00 per share, resulting in proceeds to the Company of approximately $47.3 million, net of IPO transaction costs of approximately $5.6 million. The Company used the net proceeds to repay $47.3 million of the Term Loan under the Senior Credit Facility.

5. Share-based Compensation Plans

The Company has four stock plans: the 2006 Equity and Performance Incentive Plan (the 2006 Plan), the 2006 Employee Stock Purchase Plan (the 2006 ESPP), the 2004 Stock Incentive Plan (the 2004 Plan) and the 2000 Stock Option Plan (the 2000 Plan).

2006 Plan: The 2006 Plan provides for an aggregate of up to 1,400,000 shares of CPI International s common stock to be available for awards, plus the number of shares subject to awards granted under the 2004 Plan and the 2000 Plan that are forfeited, expire or are cancelled after the effective date of the 2006 Plan. All of the Company s employees (including officers), directors, and consultants are eligible for awards under the 2006 Plan. The 2006 Plan is administered by the Compensation Committee of the Board of Directors (Compensation Committee) and awards may consist of options, stock appreciation rights, restricted stock, other stock unit awards, performance awards, dividend equivalents or any combination of the foregoing. The exercise price for stock options generally cannot be less than 100% of the fair market value of the shares on the date of grant.

2006 ESPP: The 2006 ESPP permits eligible employees to purchase common stock at a discounted price. An aggregate of 760,000 shares of common stock is reserved for issuance under this plan. The stock purchase plan is administered by the Compensation Committee of the board of directors. Employees participating in the plan may purchase stock for their accounts according to a price formula set by the Compensation Committee, as administrator, before the applicable offering period, which cannot exceed 24 months. The price per share will equal a fixed percentage (which may not be lower than 85%) of the fair market value of a share of common stock on the last day of the purchase period in the offering, or the lower of (1) a fixed percentage (not to be less than 85%) of the fair market value of a share of common stock on the date of commencement of participation in the offering and (2) a fixed percentage (not to be less than 85%) of the fair market value of a share of common stock on the date of purchase. The initial 2006 ESPP offering period began on July 1, 2006; the participants purchase price for CPI

15

International, Inc. common stock will be 85% of the closing market price on the last trading day of each quarter. Under the 2006 ESPP, the Company issued 13,387 and 14,954 shares at a discounted purchase price of $12.75 and $11.19 per share in January 2007 and October 2006, respectively.

2004 Plan: No further options are available for issuance under the 2004 Plan. The Company issued both time and performance stock option awards under the 2004 Plan. All stock option grants under the 2004 Plan were issued at exercise prices equal to or greater than the estimated market price of the Company s common stock at option grant date.

2000 Plan: No further options are available for issuance under the 2000 Plan. In accordance with the terms of the stock option agreements, the unvested stock options outstanding under the 2000 Plan became fully vested in February 2004 in connection with a business combination. The 2000 Plan option holders were offered the opportunity to either roll over their stock options from the predecessor company into options to purchase common stock of CPI International or exercise their stock options. Management elected to roll over options to purchase 912,613 shares of common stock at prices ranging from $0.20 to $0.74 per share.

Stock Options: A summary of the Company s stock option activity as of December 29, 2006, and changes during the fiscal quarter then ended is presented below:

	Number of Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at September 29, 2006	3,163,057	$ 4.51		
Granted	285,000	14.22		
Exercised	(21,914)	3.03		
Forfeited or expired				
Outstanding at December 29, 2006	3,426,143	$ 5.33	7.25	$ 34,009
Vested and expected to vest	3,380,178	$ 5.21	7.22	$ 33,922
Exercisable at December 29, 2006	2,323,919	$ 2.85	6.67	$ 28,230

The grant date fair value of awards granted during the first quarter of fiscal year 2007 was estimated as of the date of grant using the Black-Scholes options pricing model, assuming no expected dividends and the following assumptions:

Expected term (in years)	6.25
Expected volatility	49.33 %
Risk-free rate	4.56 %
Grant date fair value	$ 7.66

Since the Company s common stock has not been publicly traded for a sufficient time period, the expected volatility is based on expected volatilities of similar companies that have a longer history of

16

being publicly traded. The expected life of options granted is based on the simplified method for plain vanilla options in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 107. The risk-free rates are based on the U.S. Treasury yield in effect at the time of the grant.

The total intrinsic value of options exercised was $0.2 million during first quarter of fiscal year 2007. There were no options granted or exercised during the first quarter of fiscal year 2006.

Outstanding and exercisable options presented by exercise price as of December 29, 2006 are as follows:

	Options Outstanding		Options Exercisable	
Exercise Price	Number of Options Outstanding	Weighted-Average Remaining Contractual Life (Years)	Number of Options Exercisable	Weighted-Average Remaining Contractual Life (Years)
$ 0.20	695,126	6.20	695,126	6.20
$ 0.74	194,292	3.68	194,292	3.68
$ 1.08	8,079	7.10	8,079	7.10
$ 4.32	1,864,578	7.25	1,352,824	7.27
$ 6.61	54,480	7.75	54,480	7.75
$ 6.98	30,588	8.20	19,118	8.20
$ 14.22	285,000	9.94		
$ 18.00	294,000	9.33		
	3,426,143	7.25	2,323,919	6.67

As of December 29, 2006, there was approximately $4.5 million of total unrecognized compensation costs related to nonvested stock options, which is expected to be recognized over a weighted-average vesting period of 2.7 years.

Restricted Stock Awards: There were 9,999 shares of restricted stock outstanding as of December 29, 2006 and September 29, 2006. The restricted stock awards vest over periods of one to three years and have a 10 year contractual life.

17

A summary of the status of the Company s nonvested restricted stock awards as of December 29, 2006, and changes during the fiscal quarter then ended is presented below:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at September 29, 2006	9,999	$ 18.00
Granted		
Vested		
Forfeited		
Nonvested at December 29, 2006	9,999	$ 18.00

As of December 29, 2006, there was $0.1 million of total unrecognized compensation costs related to nonvested restricted stock awards, which is expected to be recognized over a weighted average vesting period of 1.2 years.

Share-Based Compensation Cost: There was no unrecognized compensation cost relating to stock options outstanding at the beginning of fiscal year 2006 and no stock options were granted during the first quarter of fiscal year 2006. Therefore, there was no share-based compensation cost in the first quarter of fiscal year 2006. Total share-based compensation cost for the Company s stock plans in first quarter of fiscal year 2007 comprise the following:

	Quarter Ended December 29, 2006
Share-based compensation cost recognized in the income statement by caption:	
Cost of sales	$ 39
Research and development	10
Selling and marketing	19
General and administrative	137
	$ 205
Share-based compensation cost capitalized in inventory	$ 44
Share-based compensation cost remaining in inventory at end of period	$ 29
Share-based compensation expense by type of award:	
Stock options	$ 175
Restricted stock	30
	$ 205

6. Derivative Financial Instruments

The Company uses forward exchange contracts to hedge the foreign currency exposure associated with forecasted manufacturing costs in Canada. As of December 29, 2006, CPI had outstanding forward contract commitments to purchase Canadian dollars for an aggregate U.S. notional amount of $17.3 million; the last forward contract expires on September 24, 2007. At December 29, 2006 and

September 29, 2006, the fair value of foreign currency forward contracts was a liability of $0.5 million and an asset of $0.1 million, respectively, and the unrealized (loss) gain was approximately $(0.3) million and $8 thousand, net of related tax expense, respectively.

The Company s foreign currency forward contracts are designated as a cash flow hedge and are considered highly effective, as defined by Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities. The unrealized gains and losses from foreign exchange forward contracts are included in Accumulated other comprehensive income in the condensed consolidated balance sheets, and the Company anticipates recognizing the entire unrealized loss in operating earnings within the next twelve months. Changes in the fair value of foreign currency forward contracts due to changes in time value are excluded from the assessment of effectiveness, and are recognized in General and Administrative in the condensed consolidated statements of operations when the hedged item affects earnings. The time value was not material for first quarter of fiscal years 2007 and 2006. If the transaction being hedged fails to occur, or if a portion of any derivative is ineffective, the Company promptly recognizes the gain or loss on the associated financial instrument in the condensed consolidated statements of operations. No ineffective amounts were recognized due to anticipated transactions failing to occur in the first quarter of fiscal years 2007 and 2006. Realized gains and losses from foreign currency forward contracts are recognized in cost of sales and general and administrative in the condensed consolidated statements of operations. Net income in the first quarter of fiscal year 2007 includes a recognized loss from foreign currency forward contracts of $0.1 million. Net income in the first quarter of fiscal year 2006 includes a recognized gain from foreign currency forward contracts of $0.4 million.

In April 2005, the Company expanded its use of derivatives to hedge the interest rate exposure associated with the FR Notes. On April 15, 2005, the Company entered into an $80 million interest rate swap contract (the Swap) to receive variable rate 6-month LIBOR interest and pay 4.15% fixed rate interest, which when combined with the 5.75% margin, results in a fixed rate of 9.9% on the FR Notes through January 31, 2008. The Swap interest payments are made semi-annually, beginning with the first payment on February 1, 2006. The Swap matures on January 31, 2008. In fiscal year 2005, the Company deposited $1.0 million as collateral for the Swap; the amount of collateral fluctuates based on the fair value of the Swap. In fiscal year 2006, the Company received a $0.5 million refund of the Swap collateral. The Swap collateral remaining is reported as Other long-term assets in the accompanying condensed consolidated balance sheets. The unrealized gains and losses from the Swap are included in Accumulated other comprehensive income in the condensed consolidated balance sheets. The ineffective portion of the Swap was not significant and the interest rate swap gain or loss are included in the assessment of hedge effectiveness. At December 29, 2006 and September 29, 2006, the fair value of the Swap was an asset of $1.0 million and $1.1 million, respectively, and the unrealized gain, net of related tax expense, was approximately $0.6 million and $0.7 million, respectively.

7. Income Taxes

The Company s effective tax rate was approximately 39% for the first quarter of fiscal year 2007 and 48% for the first quarter of fiscal year 2006. The effective tax rate for the first quarter of fiscal year 2006 included a $0.3 million charge attributable to the fourth quarter of fiscal year 2005; consisting of $0.5 million to correct the overstatement of tax benefits recorded in the fourth quarter of fiscal year 2005 for stock-based compensation expense that is not deductible for income tax purposes in a foreign tax jurisdiction, offset by reversal of a $0.2 million tax contingency reserve that was no longer required.

Without the correction to the overstatement of tax benefits, the Company s effective tax rate for the first quarter of fiscal year 2006 would have been approximately 41%.

8. Earnings Per Share

Basic earnings per share is computed using the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted-average number of common and dilutive potential common equivalent shares outstanding during the period. Potential common equivalent shares consist of common stock issuable upon exercise of stock options using the treasury stock method.

The following table is a reconciliation of the shares used to calculate basic and diluted earnings per share:

	Quarter Ended December 29, 2006	December 30, 2005
Weighted average common shares outstanding Basic	16,063,221	13,078,954
Effect of dilutive stock options	1,481,142	1,689,128
Weighted average common shares outstanding Diluted	17,544,363	14,768,082

As further discussed in Note 4, on April 7, 2006, in connection with the amendment and restatement of its certificate of incorporation, the Company effected a 3.059-to-1 split of its outstanding shares of common stock as of such date. All share and per share amounts have been retroactively restated to reflect this stock split.

9. Segments, Geographic and Customer Information

The Company s reportable segments are VED and satcom equipment. The VED segment develops, manufactures and distributes high power/high frequency microwave and radio frequency signal components. The satcom equipment segment manufactures and supplies high power amplifiers and networks for satellite communication uplink and industrial applications. Segment information reported below is consistent with the manner in which it is reviewed and evaluated by the Company s chief operating decision maker, its Chief Executive Officer, and is based on the nature of the Company s operations and products offered to customers.

20

Summarized financial information concerning the Company s reportable segments is shown in the following tables:

	Quarter Ended December 29, 2006	**December 30, 2005**
Sales from external customers		
VEDs	$ 66,975	$ 63,196
Satcom equipment	16,748	19,183
	$ 83,723	$ 82,379
Intersegment product transfers		
VEDs	$ 5,123	$ 6,208
Satcom equipment		
	$ 5,123	$ 6,208
EBITDA		
VEDs	$ 17,584	$ 16,065
Satcom equipment	1,497	2,891
Other	(1,996)	(6,441)
	$ 17,085	$ 12,515

Amounts not reported as VED or satcom equipment are reported as other. Other consists primarily of corporate operating expenses and certain other expenses that are managed by the corporate organization, such as business combination-related expenses, share-based compensation expense, and certain non-recurring or unusual expenses. The first quarter of fiscal year 2006 included non-recurring expenses for a special bonus of $3.25 million and expenses of $1.8 million related to the relocation of the Company s Eimac operations from its former San Carlos, California facility to its nearby Palo Alto, California and Mountain View, California facilities. The special bonus was paid to employees and directors (other than directors who are employees or affiliates of Cypress) to reward them for the increase in Company value. Relocation expenses included move expenses and unfavorable overhead absorption and manufacturing variances for the Eimacoperations.

EBITDA represents earnings before provision for income taxes, net interest expense and depreciation and amortization. For the reasons listed below, the Company believes that GAAP-based financial information for leveraged businesses such as the Company s business should be supplemented by EBITDA so that investors better understand the Company s financial performance in connection with their analysis of the Company s business:

- EBITDA is a component of the measures used by the Company s board of directors and management team to evaluate the Company s operating performance;

- the Senior Credit Facility contains covenants that require the Company to maintain certain interest expense coverage and leverage ratios that contain EBITDA as a component, and the Company s management team uses EBITDA to monitor compliance with such covenants;

- EBITDA is a component of the measures used by the Company s management team to make day-to-day operating decisions;

21

- EBITDA facilitates comparisons between the Company s operating results and those of competitors with different capital structures and therefore is a component of the measures used by the Company s management to facilitate internal comparisons to competitors results and the Company s industry in general; and

- the payment of management bonuses is contingent upon, among other things, the satisfaction by the Company of certain targets that contain EBITDA as a component.

Other companies may define EBITDA differently and, as a result, our measure of EBITDA may not be directly comparable to EBITDA of other companies. Although the Company uses EBITDA as a financial measure to assess the performance of its business, the use of EBITDA is limited because it does not include certain material costs, such as interest and taxes, necessary to operate the Company s business. When analyzing the Company s performance, EBITDA should be considered in addition to, and not as a substitute for, net income, cash flows from operating activities or other statements of operations or statements of cash flows data prepared in accordance with GAAP.

The following table reconciles net income to EBITDA:

	Quarter Ended December 29, 2006	**December 30, 2005**
Net income	$ 5,835	$ 2,215
Depreciation and amortization	2,194	2,156
Interest expense, net	5,339	6,064
Income tax expense	3,717	2,080
EBITDA	$ 17,085	$ 12,515

Geographic sales by customer location were as follows for external customers:

	Quarter Ended December 29, 2006	**December 30, 2005**
United States	$ 49,504	$ 51,000
All foreign countries	34,219	31,379
Total sales	$ 83,723	$ 82,379

Net property, plant and equipment by geographic area was as follows:

	December 29, 2006			September 29, 2006		
	Cost	Accumulated Depreciation and Amortization	Net Property, Plant and Equipment	Cost	Accumulated Depreciation and Amortization	Net Property, Plant and Equipment
United States	$ 65,345	$ (12,614)	$ 52,731	$ 64,527	$ (11,221)	$ 53,306
Canada	13,935	(1,603)	12,332	11,915	(1,440)	10,475
Other	173	(116)	57	177	(107)	70
Total	$ 79,453	$ (14,333)	$ 65,120	$ 76,619	$ (12,768)	$ 63,851

The United States Government is the only customer that accounted for 10% or more of the Company s consolidated sales in the first quarter of fiscal years 2007 and 2006. Direct sales to the United States Government were $14.9 million and $12.7 million for first quarter of fiscal years 2007 and 2006, respectively. Accounts receivable from this customer represented 14% of consolidated accounts receivable as of December 29, 2006 and September 29, 2006.

There were no individual foreign countries with sales greater than 10% of total sales for the periods presented.

10. Sale of San Carlos Assets

In February 2003, the Company entered into an agreement to sell the land and close its facilities located in San Carlos, California to consolidate the San Carlos operations into the Company s existing facility in nearby Palo Alto, California. In September 2006, the sale was completed. The aggregate sales proceeds were $24.8 million, of which $11.3 million was received in September 2006 and $13.5 million was received as advance payments in fiscal 2004. The Company had total selling costs of $1.3 million related to the sale of the San Carlos property. The aggregate sales proceeds of $24.8 million less the related selling costs of $1.3 million, offset by the land and building s net book value of approximately $23.5 million, resulted in no gain or loss on sale.

11. Special Cash Dividend

In December 2005, the Board of Directors declared and paid a special cash dividend to stockholders of $17.0 million. This dividend was paid using (a) the $10.0 million in net proceeds obtained from the additional borrowing under the Senior Credit Facility in connection with the December 2005 amendment thereto, and (b) available cash.

12. Recently Released Accounting Pronouncements

In June 2006, the Emerging Issues Task Force reached a consensus, ratified by the Financial Accounting Standards Board (FASB) in June 2006, on Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (i.e., Gross versus Net Presentation). The primary focus of this Issue is to require the disclosure of the accounting policy for any tax assessed by a government authority that is directly imposed on a revenue producing transaction (i.e., gross or net basis) for each period for which an income statement is presented if those amounts are significant. The Company is required to adopt the provisions of Issue No. 06-3 beginning in its second quarter of fiscal 2007 and its adoption is not expected to have a material impact on its financial condition or results of operations.

23

In June 2006, the FASB issued Interpretation 48, Accounting for Income Tax Uncertainties (FIN 48). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. Any differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is currently in the process of determining the impact, if any, of adopting the provisions of FIN 48 on its financial position, results of operations and liquidity.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value under other accounting pronouncements that permit or require fair value measurements, changes the methods used to measure fair value and expands disclosures about fair value measurements. In particular, disclosures are required to provide information on the extent to which fair value is used to measure assets and liabilities; the inputs used to develop measurements; and the effect of certain of the measurements on earnings (or changes in net assets). SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Early adoption, as of the beginning of an entity s fiscal year, is also permitted, provided interim financial statements have not yet been issued. The Company is currently evaluating the potential impact, if any, that the adoption of SFAS No. 157 will have on its condensed consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R), which requires an employer to recognize the overfunded or underfunded status of a defined benefit plan as an asset or liability in its condensed consolidated balance sheet. Under SFAS No. 158, actuarial gains and losses and prior service costs or credits that have not yet been recognized through earnings as net periodic benefit cost will be recognized in other comprehensive income, net of tax, until they are amortized as a component of net periodic benefit cost. SFAS No. 158 is effective as of the end of the fiscal year ending after December 15, 2006 and shall not be applied retrospectively. The Company is currently evaluating the impact, if any, that the adoption of SFAS No. 158 will have on its condensed consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB No. 108). SAB No. 108 provides guidance on how prior year misstatements should be considered when quantifying misstatements in the current year financial statements. SAB No. 108 requires registrants to quantify misstatements using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB No. 108 does not change the guidance in SAB No. 99, Materiality, when evaluating the materiality of misstatements. SAB No. 108 is effective for fiscal years ending after November 15, 2006. Upon initial application, SAB No. 108 permits a one-time cumulative effect adjustment to beginning retained earnings. The Company

believes at this time that the adoption of SAB No. 108 will not have a material impact on its condensed consolidated financial statements.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

On January 23, 2004, CPI issued $125.0 million of 8% Notes that are guaranteed by CPI International and all of CPI s domestic subsidiaries. Separate financial statements of the guarantors are not presented because (i) the guarantors are wholly-owned and have fully and unconditionally guaranteed the 8% Notes on a joint and several basis, and (ii) the Company s management has determined that such separate financial statements are not material to investors. Instead, presented below are the consolidating financial statements of: (a) the parent or CPI International, (b) the issuer, CPI, (c) the guarantor subsidiaries (all of the domestic subsidiaries), (d) the non-guarantor subsidiaries, (e) the consolidating elimination entries, and (f) the consolidated totals. The accompanying consolidating financial information should be read in connection with the condensed consolidated financial statements of CPI International.

Investments in subsidiaries are accounted for based on the equity method. The principal elimination entries eliminate investments in subsidiaries, intercompany balances, intercompany transactions and intercompany sales.

25

CONDENSED CONSOLIDATING BALANCE SHEET
As of December 29, 2006

	Parent (CPI Int l)	Issuer (CPI)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Consolidated Total
Assets						

(305
)

94,543

(1,140
)

172,611

(1,445
)
Debt Securities Issued by Corporations
73,829

(1,171
)

180,335

(2,814
)

254,164

(3,985
)
Mortgage-Backed Securities:

Residential - Government Agencies	3,025	(8)	12,215	(1,035)	15,240	(1,043)
Residential - U.S. Government-Sponsored Enterprises	103,824	(191)	—	—	103,824	(191)
Commercial - Government Agencies	—	—	178,232	(8,581)		

178,232

(8,581
)
Total Mortgage-Backed Securities
106,849

(199
)

190,447

(9,616
)

297,296

(9,815
)
Total
$
260,475

$
(1,677
)

$
470,871

$
(13,608
)

$
731,346

$
(15,285
)
Held-to-Maturity:

Debt Securities Issued by the U.S. Treasury and Government Agencies	$ 70,016	$ (134)	$ 144,222	$ (1,025)	$ 214,238	$ (1,159)
Debt Securities Issued by Corporations	46,196	(349)	82,109	(3,093)	128,305	(3,442)

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Mortgage-Backed Securities:

Residential - Government Agencies
280,967

(1,207
)

845,911

(19,429
)

1,126,878

(20,636
)
Residential - U.S. Government-Sponsored Enterprises
45,754

(15
)

—

—

45,754

(15
)
Commercial - Government Agencies
124,594

(179
)

171,091

(3,612
)

295,685

(3,791
)
Total Mortgage-Backed Securities
451,315

(1,401
)

1,017,002

(23,041
)

1,468,317

(24,442
)
Total
$
567,527

$
(1,884
)

$
1,243,333

$
(27,159
)

$

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

1,810,860

$
(29,043
)

12

---

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

The Company does not believe that the investment securities that were in an unrealized loss position as of March 31, 2015, which were comprised of 119 securities, represent an other-than-temporary impairment. Total gross unrealized losses were primarily attributable to changes in interest rates, relative to when the investment securities were purchased, and not due to the credit quality of the investment securities. As of March 31, 2015 and December 31, 2014, the gross unrealized losses reported for mortgage-backed securities were primarily related to investment securities issued by the Government National Mortgage Association. The Company does not intend to sell the investment securities that were in an unrealized loss position and it is not more likely than not that the Company will be required to sell the investment securities before recovery of their amortized cost basis, which may be at maturity.

Interest income from taxable and non-taxable investment securities for the three months ended March 31, 2015 and 2014 were as follows:

	Three Months Ended March 31,	
(dollars in thousands)	2015	2014
Taxable	$29,292	$33,427
Non-Taxable	5,313	5,222
Total Interest Income from Investment Securities	$34,605	$38,649

As of March 31, 2015, included in the Company's investment securities portfolio were debt securities issued by political subdivisions within the State of Hawaii of $604.3 million, representing 59% of the total fair value of the Company's municipal debt securities. Of the entire Hawaii municipal bond portfolio, 91% were credit-rated Aa2 or better by Moody's while most of the remaining Hawaii municipal bonds were credit-rated A2 or better by at least one nationally recognized statistical rating organization. Approximately 77% of the Company's Hawaii municipal bond holdings were general obligation issuances. As of March 31, 2015, there were no other holdings of municipal debt securities that were issued by a single state or political subdivision which comprised more than 10% of the total fair value of the Company's municipal debt securities.

As of March 31, 2015, the carrying value of the Company’s Federal Home Loan Bank of Seattle ("FHLB Seattle") and Federal Reserve Bank stock was as follows:

(dollars in thousands)	March 31, 2015	December 31, 2014
Federal Home Loan Bank Stock	$44,463	$47,075
Federal Reserve Bank Stock	19,419	19,299
Total	$63,882	$66,374

These securities can only be redeemed or sold at their par value and only to the respective issuing government-supported institution or to another member institution. The Company records these non-marketable equity securities as a component of other assets and periodically evaluates these securities for impairment. Management considers these non-marketable equity securities to be long-term investments. Accordingly, when evaluating these securities for impairment, management considers the ultimate recoverability of the par value rather than recognizing temporary declines in value.

On February 27, 2015, the FHLB Seattle and the Federal Home Loan Bank of Des Moines announced that the members of both banks have ratified the Merger Agreement approved by their boards of directors in September 2014. The combined bank will be headquartered in Des Moines and maintain a western regional office in Seattle. Pending certain closing conditions, the merger is anticipated to become effective by mid-year 2015. The merger is not expected to have a material impact on the Company's Consolidated Financial Statements or the Company's dealings with the combined bank.

Visa Class B Restricted Shares

In 2008, the Company received Visa Class B restricted shares as part of Visa’s initial public offering. These shares are transferable only under limited circumstances until they can be converted into the publicly traded Class A common shares. This conversion will not occur until the settlement of certain litigation which is indemnified by Visa members such as the Company. Visa funded an escrow account from its initial public offering to settle these litigation claims. Should this escrow account not be sufficient to cover these litigation claims, Visa is entitled to fund additional amounts to the escrow account by reducing each member bank's Class B conversion ratio to unrestricted Class A shares. As of March 31, 2015, the conversion ratio was 1.6483.

During the first quarter of 2015, the Company recorded a $10.1 million net gain on the sale of 95,000 Visa Class B shares. Concurrent with these sales, the Company entered into an agreement with the buyer that requires payment to the buyer in the

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

event Visa further reduces the conversion ratio. Based on the existing transfer restriction and the uncertainty of the outcome of certain litigation relating to Visa, the remaining 297,814 Class B shares (490,887 Class A equivalents) that the Company owns are carried at a zero cost basis. The Company also contributed 4,700 Visa Class B restricted shares to the Bank of Hawaii Foundation during first quarter of 2015. The contribution had no impact on noninterest expense; however, the contribution favorably impacted our effective tax rate in 2015.

Note 3. Loans and Leases and the Allowance for Loan and Lease Losses

Loans and Leases

The Company’s loan and lease portfolio was comprised of the following as of March 31, 2015 and December 31, 2014:

(dollars in thousands)	March 31, 2015	December 31, 2014
Commercial		
Commercial and Industrial	$1,141,408	$1,055,243
Commercial Mortgage	1,477,902	1,437,513
Construction	111,381	109,183
Lease Financing	224,419	226,189
Total Commercial	2,955,110	2,828,128
Consumer		
Residential Mortgage	2,699,434	2,571,090
Home Equity	884,742	866,688
Automobile	339,686	323,848
Other [1]	299,656	307,835
Total Consumer	4,223,518	4,069,461
Total Loans and Leases	$7,178,628	$6,897,589

[1] Comprised of other revolving credit, installment, and lease financing.

Most of the Company's lending activity is with customers located in the State of Hawaii. A substantial portion of the Company's real estate loans are secured by real estate in Hawaii.

Net gains related to sales of residential mortgage loans, recorded as a component of mortgage banking income were $0.5 million and $0.7 million for the three months March 31, 2015 and 2014, respectively.

Table of Contents

Allowance for Loan and Lease Losses (the "Allowance")

The following presents by portfolio segment, the activity in the Allowance for the three months ended March 31, 2015 and 2014. The following also presents by portfolio segment, the balance in the Allowance disaggregated on the basis of the Company's impairment measurement method and the related recorded investment in loans and leases as of March 31, 2015 and 2014.

(dollars in thousands)	Commercial	Consumer	Total
Three Months Ended March 31, 2015			
Allowance for Loan and Lease Losses:			
Balance at Beginning of Period	$64,551	$44,137	$108,688
Loans and Leases Charged-Off	(235)	(3,853)	(4,088)
Recoveries on Loans and Leases Previously Charged-Off	736	2,125	2,861
Net Loans and Leases Recovered (Charged-Off)	501	(1,728)	(1,227)
Provision for Credit Losses	782	(782)	—
Balance at End of Period	$65,834	$41,627	$107,461
As of March 31, 2015			
Allowance for Loan and Lease Losses:			
Individually Evaluated for Impairment	$2,212	$3,534	$5,746
Collectively Evaluated for Impairment	63,622	38,093	101,715
Total	$65,834	$41,627	$107,461
Recorded Investment in Loans and Leases:			
Individually Evaluated for Impairment	$26,084	$39,453	$65,537
Collectively Evaluated for Impairment	2,929,026	4,184,065	7,113,091
Total	$2,955,110	$4,223,518	$7,178,628
Three Months Ended March 31, 2014			
Allowance for Loan and Lease Losses:			
Balance at Beginning of Period	$71,446	$44,008	$115,454
Loans and Leases Charged-Off	(819)	(3,219)	(4,038)
Recoveries on Loans and Leases Previously Charged-Off	941	1,769	2,710
Net Loans and Leases Recovered (Charged-Off)	122	(1,450)	(1,328)
Provision for Credit Losses	(178)	178	—
Balance at End of Period	$71,390	$42,736	$114,126
As of March 31, 2014			
Allowance for Loan and Lease Losses:			
Individually Evaluated for Impairment	$8,903	$3,699	$12,602
Collectively Evaluated for Impairment	62,487	39,037	101,524
Total	$71,390	$42,736	$114,126
Recorded Investment in Loans and Leases:			
Individually Evaluated for Impairment	$29,815	$37,780	$67,595
Collectively Evaluated for Impairment	2,542,348	3,599,914	6,142,262
Total	$2,572,163	$3,637,694	$6,209,857

Table of Contents

Credit Quality Indicators

The Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company uses an internal credit risk rating system that categorizes loans and leases into pass, special mention, or classified categories. Credit risk ratings are applied individually to those classes of loans and leases that have significant or unique credit characteristics that benefit from a case-by-case evaluation. These are typically loans and leases to businesses or individuals in the classes which comprise the commercial portfolio segment. Groups of loans and leases that are underwritten and structured using standardized criteria and characteristics, such as statistical models (e.g., credit scoring or payment performance), are typically risk-rated and monitored collectively. These are typically loans and leases to individuals in the classes which comprise the consumer portfolio segment.

The following are the definitions of the Company’s credit quality indicators:

Pass:	Loans and leases in all classes within the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan or lease agreement. Management believes that there is a low likelihood of loss related to those loans and leases that are considered pass.
Special Mention:	Loans and leases in the classes within the commercial portfolio segment that have potential weaknesses that deserve management’s close attention. If not addressed, these potential weaknesses may result in deterioration of the repayment prospects for the loan or lease. The special mention credit quality indicator is not used for classes of loans and leases that are included in the consumer portfolio segment. Management believes that there is a moderate likelihood of some loss related to those loans and leases that are considered special mention.
Classified:	Loans and leases in the classes within the commercial portfolio segment that are inadequately protected by the sound worth and paying capacity of the borrower or of the collateral pledged, if any. Classified loans and leases are also those in the classes within the consumer portfolio segment that are past due 90 days or more as to principal or interest. Residential mortgage loans that are past due 90 days or more as to principal or interest may be considered pass if the Company is in the process of collection and the current loan-to-value ratio is 60% or less. Home equity loans that are past due 90 days or more as to principal or interest may be considered pass if the Company is in the process of collection, the first mortgage is with the Company, and the current combined loan-to-value ratio is 60% or less. Residential mortgage and home equity loans may be current as to principal and interest, but may be considered classified for a period of up to six months following a loan modification. Following a period of demonstrated performance in accordance with the modified contractual terms, the loan may be removed from classified status. Management believes that there is a distinct possibility that the Company will sustain some loss if the deficiencies related to classified loans and leases are not corrected in a timely manner.

Table of Contents

The Company's credit quality indicators are periodically updated on a case-by-case basis. The following presents by class and by credit quality indicator, the recorded investment in the Company's loans and leases as of March 31, 2015 and December 31, 2014.

	March 31, 2015				
(dollars in thousands)	Commercial and Industrial	Commercial Mortgage	Construction	Lease Financing	Total Commercial
Pass	$1,096,131	$1,400,719	$109,608	$223,942	$2,830,400
Special Mention	14,982	33,841	—	91	48,914
Classified	30,295	43,342	1,773	386	75,796
Total	$1,141,408	$1,477,902	$111,381	$224,419	$2,955,110
(dollars in thousands)	Residential Mortgage	Home Equity	Automobile	Other [1]	Total Consumer
Pass	$2,684,218	$880,349	$339,149	$298,894	$4,202,610
Classified	15,216	4,393	537	762	20,908
Total	$2,699,434	$884,742	$339,686	$299,656	$4,223,518
Total Recorded Investment in Loans and Leases					$7,178,628

	December 31, 2014				
(dollars in thousands)	Commercial and Industrial	Commercial Mortgage	Construction	Lease Financing	Total Commercial
Pass	$1,001,474	$1,358,812	$107,381	$225,783	$2,693,450
Special Mention	17,364	45,082	—	17	62,463
Classified	36,405	33,619	1,802	389	72,215
Total	$1,055,243	$1,437,513	$109,183	$226,189	$2,828,128
(dollars in thousands)	Residential Mortgage	Home Equity	Automobile	Other [1]	Total Consumer
Pass	$2,556,140	$862,258	$323,232	$307,123	$4,048,753
Classified	14,950	4,430	616	712	20,708
Total	$2,571,090	$866,688	$323,848	$307,835	$4,069,461
Total Recorded Investment in Loans and Leases					$6,897,589

[1] Comprised of other revolving credit, installment, and lease financing.

Table of Contents

Aging Analysis

The following presents by class, an aging analysis of the Company's loan and lease portfolio as of March 31, 2015 and December 31, 2014.

(dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	Past Due 90 Days or More	Non-Accrual	Total Past Due and Non-Accrual	Current	Total Loans and Leases	Non-Accrual Loans and Leases that are Current [2]
As of March 31, 2015								
Commercial								
Commercial and Industrial	$2,852	$180	$—	$8,641	$11,673	$1,129,735	$1,141,408	$7,402
Commercial Mortgage	1,126	34	—	732	1,892	1,476,010	1,477,902	508
Construction	—	—	—	—	—	111,381	111,381	—
Lease Financing	—	—	—	—	—	224,419	224,419	—
Total Commercial	3,978	214	—	9,373	13,565	2,941,545	2,955,110	7,910
Consumer								
Residential Mortgage	6,702	2,208	3,914	14,344	27,168	2,672,266	2,699,434	1,515
Home Equity	3,804	1,378	2,425	2,965	10,572	874,170	884,742	965
Automobile	6,126	963	537	—	7,626	332,060	339,686	—
Other [1]	2,122	1,200	1,078	—	4,400	295,256	299,656	—
Total Consumer	18,754	5,749	7,954	17,309	49,766	4,173,752	4,223,518	2,480
Total	$22,732	$5,963	$7,954	$26,682	$63,331	$7,115,297	$7,178,628	$10,390
As of December 31, 2014								
Commercial								
Commercial and Industrial	$992	$356	$2	$9,088	$10,438	$1,044,805	$1,055,243	$7,819
Commercial Mortgage	458	—	—	745	1,203	1,436,310	1,437,513	—
Construction	—	—	—	—	—	109,183	109,183	—
Lease Financing	—	—	—	—	—	226,189	226,189	—
Total Commercial	1,450	356	2	9,833	11,641	2,816,487	2,828,128	7,819
Consumer								
Residential Mortgage	4,907	2,107	4,506	14,841	26,361	2,544,729	2,571,090	632
Home Equity	3,461	2,661	2,596	3,097	11,815	854,873	866,688	375
Automobile	7,862	1,483	616	—	9,961	313,887	323,848	—
Other [1]	2,416	1,049	941	—	4,406	303,429	307,835	—
Total Consumer	18,646	7,300	8,659	17,938	52,543	4,016,918	4,069,461	1,007
Total	$20,096	$7,656	$8,661	$27,771	$64,184	$6,833,405	$6,897,589	$8,826

[1] Comprised of other revolving credit, installment, and lease financing.

[2] Represents non-accrual loans that are not past due 30 days or more; however, full payment of principal and interest is still not expected.

18

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

Impaired Loans

The following presents by class, information related to impaired loans as of March 31, 2015 and December 31, 2014.

(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance for Loan Losses
March 31, 2015			
Impaired Loans with No Related Allowance Recorded:			
Commercial			
Commercial and Industrial	$11,798	$17,102	
Commercial Mortgage	6,407	6,407	
Construction	1,668	1,668	
Total Commercial	19,873	25,177	—
Total Impaired Loans with No Related Allowance Recorded	$19,873	$25,177	$—
Impaired Loans with an Allowance Recorded:			
Commercial			
Commercial and Industrial	$6,211	$12,811	$2,212
Total Commercial	6,211	12,811	2,212
Consumer			
Residential Mortgage	31,725	37,786	3,408
Home Equity	1,203	1,203	18
Automobile	5,546	5,546	76
Other [1]	979	979	32
Total Consumer	39,453	45,514	3,534
Total Impaired Loans with an Allowance Recorded	$45,664	$58,325	$5,746
Impaired Loans:			
Commercial	$26,084	$37,988	$2,212
Consumer	39,453	45,514	3,534
Total Impaired Loans	$65,537	$83,502	$5,746
December 31, 2014			
Impaired Loans with No Related Allowance Recorded:			
Commercial			
Commercial and Industrial	$9,763	$15,013	$—
Commercial Mortgage	6,480	6,480	—
Construction	1,689	1,689	—
Total Commercial	17,932	23,182	—
Total Impaired Loans with No Related Allowance Recorded	$17,932	$23,182	$—
Impaired Loans with an Allowance Recorded:			
Commercial			
Commercial and Industrial	$7,184	$13,784	$2,387
Total Commercial	7,184	13,784	2,387
Consumer			
Residential Mortgage	32,331	37,989	3,445

Home Equity	1,012	1,012	16
Automobile	5,375	5,375	66
Other [1]	913	913	34
Total Consumer	39,631	45,289	3,561
Total Impaired Loans with an Allowance Recorded	$46,815	$59,073	$5,948
Impaired Loans:			
Commercial	$25,116	$36,966	$2,387
Consumer	39,631	45,289	3,561
Total Impaired Loans	$64,747	$82,255	$5,948

[1] Comprised of other revolving credit and installment financing.

Table of Contents

The following presents by class, information related to the average recorded investment and interest income recognized on impaired loans for the three months ended March 31, 2015 and 2014.

(dollars in thousands)	Three Months Ended March 31, 2015		Three Months Ended March 31, 2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Impaired Loans with No Related Allowance Recorded:				
Commercial				
Commercial and Industrial	$10,781	$ 98	$12,875	$ 92
Commercial Mortgage	6,444	65	11,036	55
Construction	1,679	27	1,056	16
Total Commercial	18,904	190	24,967	163
Consumer				
Other [1]	—	—	6	—
Total Consumer	—	—	6	—
Total Impaired Loans with No Related Allowance Recorded	$18,904	$ 190	$24,973	$ 163
Impaired Loans with an Allowance Recorded:				
Commercial				
Commercial and Industrial	$6,698	$ 26	$9,176	$ 28
Total Commercial	6,698	26	9,176	28
Consumer				
Residential Mortgage	32,028	267	31,841	236
Home Equity	1,108	8	876	5
Automobile	5,461	104	5,124	107
Other [1]	946	22	367	8
Total Consumer	39,543	401	38,208	356
Total Impaired Loans with an Allowance Recorded	$46,241	$ 427	$47,384	$ 384
Impaired Loans:				
Commercial	$25,602	$ 216	$34,143	$ 191
Consumer	39,543	401	38,214	356
Total Impaired Loans	$65,145	$ 617	$72,357	$ 547

[1] Comprised of other revolving credit and installment financing.

For the three months ended March 31, 2015 and 2014, the amounts of interest income recognized by the Company within the periods that the loans were impaired were primarily related to loans modified in a troubled debt restructuring that remained on accrual status. For the three months ended March 31, 2015 and 2014, the amount of interest income recognized using a cash-basis method of accounting during the periods that the loans were impaired was not material.

Modifications

A modification of a loan constitutes a troubled debt restructuring ("TDR") when the Company for economic or legal reasons related to a borrower's financial difficulties grants a concession to the borrower that it would not otherwise

consider. Loans modified in a TDR were $61.8 million and $60.2 million as of March 31, 2015 and December 31, 2014, respectively. There were no commitments to lend additional funds on loans modified in a TDR as of March 31, 2015 and December 31, 2014.

The Company offers various types of concessions when modifying a loan or lease. Commercial and industrial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial mortgage and construction loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a co-borrower or guarantor. Construction loans modified in a TDR may also involve extending the interest-only payment period. Residential mortgage loans modified in a TDR generally include a lower interest rate and the loan being fully amortized for up to 40 years from the modification effective date. In some cases, the Company may forbear a portion of the unpaid principal balance with a balloon payment due upon maturity or pay-off of the loan. Land loans are also included in the class of residential mortgage loans. Land loans are typically structured as interest-only monthly payments with a balloon payment due at maturity. Land loans modification usually involved extending the interest-only monthly payments up to an additional five years with a balloon payment due at maturity, or re-amortizing the remaining balance over a period up to 360 months. Interest rates are not changed for land loan modifications. Home equity modifications are made infrequently and uniquely designed to meet the specific

Table of Contents

needs of each borrower. Automobile loans modified in a TDR are primarily comprised of loans where the Company has lowered monthly payments by extending the term.

Loans modified in a TDR are typically already on non-accrual status and partial charge-offs have in some cases already been taken against the outstanding loan balance. As a result, loans modified in a TDR may have the financial effect of increasing the specific Allowance associated with the loan. An Allowance for impaired consumer and commercial loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent. Management exercises significant judgment in developing these estimates.

The following presents by class, information related to loans modified in a TDR during the three months ended March 31, 2015 and 2014.

Troubled Debt Restructurings (dollars in thousands)	Loans Modified as a TDR for the Three Months Ended March 31, 2015			Loans Modified as a TDR for the Three Months Ended March 31, 2014		
	Number of Contracts	Recorded Investment (as of period end)[1]	Increase in Allowance (as of period end)[1]	Number of Contracts	Recorded Investment (as of period end)[1]	Increase in Allowance (as of period end)[1]
Commercial						
Commercial and Industrial	17	$ 2,687	$ 1	18	$ 5,883	$ 120
Commercial Mortgage	1	507	—	1	365	—
Total Commercial	18	3,194	1	19	6,248	120
Consumer						
Residential Mortgage	5	2,122	61	2	733	23
Home Equity	2	203	3	1	74	1
Automobile	35	780	11	37	626	9
Other [2]	22	151	5	10	95	3
Total Consumer	64	3,256	80	50	1,528	36
Total	82	$ 6,450	$ 81	69	$ 7,776	$ 156

[1] The period end balances reflect all paydowns and charge-offs since the modification date. TDRs fully paid-off, charged-off, or foreclosed upon by period end are not included.

[2] Comprised of other revolving credit and installment financing.

The following presents by class, all loans modified in a TDR that defaulted during the three months ended March 31, 2015 and 2014, and within twelve months of their modification date. A TDR is considered to be in default once it becomes 60 days or more past due following a modification.

TDRs that Defaulted During the Period, Within Twelve Months of their Modification Date (dollars in thousands)	Three Months Ended March 31, 2015		Three Months Ended March 31, 2014	
	Number of Contracts	Recorded Investment (as of period end)[1]	Number of Contracts	Recorded Investment (as of period end)[1]
Consumer				
Residential Mortgage	1	$ 306	2	$ 517
Automobile	7	152	4	53
Other [2]	8	61	3	21
Total Consumer	16	519	9	591
Total	16	$ 519	9	$ 591

[1] The period end balances reflect all paydowns and charge-offs since the modification date. TDRs fully paid-off, charged-off, or foreclosed upon by period end are not included.

[2] Comprised of other revolving credit and installment financing.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The specific Allowance associated with the loan may be increased, adjustments may be made in the allocation of the Allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan.

Foreclosure Proceedings

Consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure totaled $9.8 million as of March 31, 2015.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

Note 4. Mortgage Servicing Rights

The Company's portfolio of residential mortgage loans serviced for third parties was $2.8 billion as of March 31, 2015 and $2.9 billion as of December 31, 2014. Substantially all of these loans were originated by the Company and sold to third parties on a non-recourse basis with servicing rights retained. These retained servicing rights are recorded as a servicing asset and are initially recorded at fair value (see Note 13 to the Consolidated Financial Statements for more information). Changes to the balance of mortgage servicing rights are recorded in mortgage banking income in the Company's consolidated statements of income.

The Company's mortgage servicing activities include collecting principal, interest, and escrow payments from borrowers; making tax and insurance payments on behalf of borrowers; monitoring delinquencies and executing foreclosure proceedings; and accounting for and remitting principal and interest payments to investors. Servicing income, including late and ancillary fees, was $1.9 million and $2.0 million for the three months ended March 31, 2015 and 2014. Servicing income is recorded in mortgage banking income in the Company's consolidated statements of income. The Company's residential mortgage investor loan servicing portfolio is primarily comprised of fixed rate loans concentrated in Hawaii.

For the three months ended March 31, 2015 and 2014, the change in the carrying value of the Company's mortgage servicing rights accounted for under the fair value measurement method was as follows:

	Three Months Ended March 31,	
(dollars in thousands)	2015	2014
Balance at Beginning of Period	$2,604	$3,826
Change in Fair Value:		
Due to Change in Valuation Assumptions [1]	(251)	(349)
Due to Payoffs	(76)	(96)
Total Changes in Fair Value of Mortgage Servicing Rights	(327)	(445)
Balance at End of Period	$2,277	$3,381

[1] Principally represents changes in discount rates and loan repayment rate assumptions, mostly due to changes in interest rates.

For the three months ended March 31, 2015 and 2014, the change in the carrying value of the Company's mortgage servicing rights accounted for under the amortization method, net of valuation allowance, was as follows:

	Three Months Ended March 31,	
(dollars in thousands)	2015	2014
Balance at Beginning of Period	$22,091	$24,297
Servicing Rights that Resulted From Asset Transfers	134	354
Amortization	(839)	(654)
Valuation Allowance Provision	(20)	—
Balance at End of Period	$21,366	$23,997
Valuation Allowance:		
Balance at Beginning of Period	$(57)	$—
Valuation Allowance Provision	(20)	—
Balance at End of Period	$(77)	$—
Fair Value of Mortgage Servicing Rights Accounted for Under the Amortization Method		

Beginning of Period	$22,837	$30,100
End of Period	$21,431	$28,303

22

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

The key data and assumptions used in estimating the fair value of the Company's mortgage servicing rights as of March 31, 2015 and December 31, 2014 were as follows:

	March 31, 2015		December 31, 2014	
Weighted-Average Constant Prepayment Rate [1]	12.96	%	11.62	%
Weighted-Average Life (in years)	5.83		6.28	
Weighted-Average Note Rate	4.27	%	4.28	%
Weighted-Average Discount Rate [2]	10.32	%	10.61	%

[1] Represents annualized loan repayment rate assumption.

[2] Derived from multiple interest rate scenarios that incorporate a spread to the London Interbank Offered Rate swap curve and market volatilities.

A sensitivity analysis of the Company's fair value of mortgage servicing rights to changes in certain key assumptions as of March 31, 2015 and December 31, 2014 is presented in the following table.

(dollars in thousands)	March 31, 2015		December 31, 2014	
Constant Prepayment Rate				
Decrease in fair value from 25 basis points ("bps") adverse change	$(236	)	$ (265	)
Decrease in fair value from 50 bps adverse change	(467	)	(524	)
Discount Rate				
Decrease in fair value from 25 bps adverse change	(224	)	(250	)
Decrease in fair value from 50 bps adverse change	(445	)	(495	)

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. Also, the effect of changing one key assumption without changing other assumptions is not realistic.

Note 5. Affordable Housing Projects Tax Credit Partnerships

The Company makes certain equity investments in various limited partnerships that sponsor affordable housing projects utilizing the Low Income Housing Tax Credit (LIHTC) pursuant to Section 42 of the Internal Revenue Code. The purpose of these investments is to achieve a satisfactory return on capital, to facilitate the sale of affordable housing product offerings, and to assist in achieving goals associated with the Community Reinvestment Act. The primary activities of the limited partnerships include the identification, development, and operation of multi-family housing that is leased to qualifying residential tenants. Generally, these types of investments are funded through a combination of debt and equity.

The Company is a limited partner in each LIHTC Partnership. A separate unrelated third party is the general partner. Each limited partnership is managed by the general partner, who exercises full control over the affairs of the limited partnership. The general partner has all the rights, powers and authority granted or permitted to be granted to a general partner of a limited partnership. Duties entrusted to the general partner of each limited partnership include, but are not limited to: investment in operating companies, company expenditures, investment of excess funds, borrowing funds, employment of agents, disposition of fund property, prepayment and refinancing of liabilities, votes and consents, contract authority, disbursement of funds, accounting methods, tax elections, bank accounts, insurance, litigation, cash reserve, and use of working capital reserve funds. Except for limited rights granted to consent to certain transactions, the limited partner(s) may not participate in the operation, management, or control of the limited partnership's business, transact any business in the limited partnership's name or have any power to sign documents for or otherwise bind the limited partnership. In addition, the general partner may only be removed by the limited partner(s) in the event the general partner fails to comply with the terms of the agreement or is negligent in performing its duties.

The general partner of each limited partnership has both the power to direct the activities which most significantly affect the performance of each partnership and the obligation to absorb losses or the right to receive benefits that could be significant to the entities. Therefore, the Company has determined that it is not the primary beneficiary of any LIHTC partnership. The Company uses the effective yield method to account for its pre-2015 investments in these entities. Beginning January 1, 2015, any new investments that meet the requirements of the proportional amortization method will be recognized using the proportional amortization method. As of March 31, 2015, there are no investments accounted for under the proportional amortization method. The Company's net affordable housing tax credit investments and related unfunded commitments were $66.6 million and $68.5 million as of March 31, 2015 and December 31, 2014, respectively, and are included in other assets in the consolidated statements of condition.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

Unfunded Commitments

As of March 31, 2015, the expected payments for unfunded affordable housing commitments were as follows:

(dollars in thousands)	Amount
2015	$12,426
2016	13,865
2017	471
2018	15
2019	75
Thereafter	68
Total Unfunded Commitments	$26,920

The following table presents tax credits and other tax benefits recognized and amortization expense related to affordable housing for the three months ended March 31, 2015 and 2014.

	Three Months Ended March 31,	
(dollars in thousands)	2015	2014
Effective Yield Method		
Tax credits and other tax benefits recognized	$3,389	$2,711
Amortization Expense in Provision for Income Taxes	1,893	1,402

There were no sales or impairment losses of LIHTC investments for the three months ended March 31, 2015 and 2014.

Note 6. Balance Sheet Offsetting

Interest Rate Swap Agreements (“Swap Agreements”)
The Company enters into swap agreements to facilitate the risk management strategies of a small number of commercial banking customers. The Company mitigates the risk of entering into these agreements by entering into equal and offsetting swap agreements with highly-rated third party financial institutions. The swap agreements are free-standing derivatives and are recorded at fair value in the Company's consolidated statements of condition (asset positions are included in other assets and liability positions are included in other liabilities). The Company is party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral, usually in the form of marketable securities, is posted by the counterparty with net liability positions in accordance with contract thresholds. The Company had net liability positions with its financial institution counterparties totaling $16.2 million as of March 31, 2015 and December 31, 2014. The fair value of collateral posted by the Company for these net liability positions is shown in the table below. See Note 11 to the Consolidated Financial Statements for more information.
Securities Sold Under Agreements to Repurchase (“Repurchase Agreements”)
The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated statements of condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. As a result, there is no offsetting

or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Company does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Company be in default (e.g., fails to make an interest payment to the counterparty). For private institution repurchase agreements, if the private institution counterparty were to default (e.g., declare bankruptcy), the Company could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

collection on the amount of collateral value in excess of the repurchase agreement fair value. The collateral is held by a third party financial institution in the counterparty's custodial account. The counterparty has the right to sell or repledge the investment securities. For government entity repurchase agreements, the collateral is held by the Company in a segregated custodial account under a tri-party agreement.

The following table presents the assets and liabilities subject to an enforceable master netting arrangement, or repurchase agreements, as of March 31, 2015 and December 31, 2014. The swap agreements we have with our commercial banking customers are not subject to an enforceable master netting arrangement, and therefore, are excluded from this table.

	(i)	(ii)	(iii) = (i)-(ii)	(iv)		(v) = (iii)-(iv)
				Gross Amounts Not Offset in the Statements of Condition		
(dollars in thousands)	Gross Amounts Recognized in the Statements of Condition	Gross Amounts Offset in the Statements of Condition	Net Amounts Presented in the Statements of Condition	Netting Adjustments per Master Netting Arrangements	Fair Value of Collateral Pledged [1]	Net Amount
March 31, 2015						
Assets:						
Interest Rate Swap Agreements:						
Institutional Counterparties	$—	$—	$—	$—	$—	$—
Liabilities:						
Interest Rate Swap Agreements:						
Institutional Counterparties	16,185	—	16,185	—	—	16,185
Repurchase Agreements:						
Private Institutions	600,000	—	600,000	—	600,000	—
Government Entities	72,329	—	72,329	—	72,329	—
	$672,329	$—	$672,329	$—	$672,329	$—
December 31, 2014						
Assets:						
Interest Rate Swap Agreements:						
Institutional Counterparties	$28	$—	$28	$28	$—	$—
Liabilities:						
Interest Rate Swap Agreements:						
Institutional Counterparties	16,268	—	16,268	28	—	16,240

Repurchase Agreements:						
Private Institutions	600,000	—	600,000	—	600,000	—
Government Entities	88,601	—	88,601	—	88,601	—
	$688,601	$—	$688,601	$—	$688,601	$—

[1] The application of collateral cannot reduce the net amount below zero. Therefore, excess collateral is not reflected in this table. For repurchase agreements with private institutions, the fair value of investment securities pledged was $0.7 billion as of March 31, 2015 and December 31, 2014. For repurchase agreements with government entities, the investment securities pledged to each government entity collectively secure both deposits as well as repurchase agreements. The Company had government entity deposits totaling $1.2 billion and $1.3 billion as of March 31, 2015 and December 31, 2014, respectively. The investment securities pledged as of March 31, 2015 and December 31, 2014 had a fair value of $1.9 billion and $2.1 billion, respectively.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

Note 7. Accumulated Other Comprehensive Income (Loss)

The following table presents the components of other comprehensive income (loss) for the three months ended March 31, 2015 and 2014:

(dollars in thousands)	Before Tax	Tax Effect	Net of Tax
Three Months Ended March 31, 2015			
Net Unrealized Gains (Losses) on Investment Securities:			
Net Unrealized Gains (Losses) Arising During the Period	$8,711	$3,435	$5,276
Amounts Reclassified from Accumulated Other Comprehensive Income (Loss) that (Increase) Decrease Net Income:			
Amortization of Unrealized Holding (Gains) Losses on Held-to-Maturity Securities [1]	30	12	18
Net Unrealized Gains (Losses) on Investment Securities	8,741	3,447	5,294
Defined Benefit Plans:			
Amortization of Net Actuarial Losses (Gains)	443	174	269
Amortization of Prior Service Credit	(81)	(32)	(49)
Defined Benefit Plans, Net	362	142	220
Other Comprehensive Income (Loss)	$9,103	$3,589	$5,514
Three Months Ended March 31, 2014			
Net Unrealized Gains (Losses) on Investment Securities:			
Net Unrealized Gains (Losses) Arising During the Period	$10,697	$4,224	$6,473
Amounts Reclassified from Accumulated Other Comprehensive Income (Loss) that (Increase) Decrease Net Income:			
Amortization of Unrealized Holding (Gains) Losses on Held-to-Maturity Securities [1]	(333)	(131)	(202)
Net Unrealized Gains (Losses) on Investment Securities	10,364	4,093	6,271
Defined Benefit Plans:			
Amortization of Net Actuarial Losses (Gains)	339	134	205
Amortization of Prior Service Credit	(81)	(32)	(49)
Defined Benefit Plans, Net	258	102	156
Other Comprehensive Income (Loss)	$10,622	$4,195	$6,427

[1] The amount relates to the amortization/accretion of unrealized net gains and losses related to the Company's reclassification of available-for-sale investment securities to the held-to-maturity category. The unrealized net gains/losses will be amortized/accreted over the remaining life of the investment securities as an adjustment of yield.

The following table presents the changes in each component of accumulated other comprehensive income (loss), net of tax, for the three months ended March 31, 2015 and 2014:

(dollars in thousands)	Investment Securities-Available-for-Sale	Investment Securities-Held-to-Maturity	Defined Benefit Plans	Accumulated Other Comprehensive Income (Loss)
Three Months Ended March 31, 2015				
Balance at Beginning of Period	$ 15,984	$ (8,555)	$(34,115)	$(26,686)
Other Comprehensive Income (Loss) Before Reclassifications	5,276	—	—	5,276
Amounts Reclassified from Accumulated Other	—	18	220	238

Comprehensive Income (Loss)				
Total Other Comprehensive Income (Loss)	5,276	18	220	5,514
Balance at End of Period	$ 21,260	$ (8,537)	$ (33,895)	$ (21,172)
Three Months Ended March 31, 2014				
Balance at Beginning of Period	$ (1,300)	$ (8,129)	$ (22,394)	$ (31,823)
Other Comprehensive Income (Loss) Before Reclassifications	6,473	—	—	6,473
Amounts Reclassified from Accumulated Other Comprehensive Income (Loss)	—	(202)	156	(46)
Total Other Comprehensive Income (Loss)	6,473	(202)	156	6,427
Balance at End of Period	$ 5,173	$ (8,331)	$ (22,238)	$ (25,396)

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

The following table presents the amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three months ended March 31, 2015 and 2014:

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss)[1]		Affected Line Item in the Statement Where Net Income Is Presented
	Three Months Ended March 31,		
(dollars in thousands)	2015	2014	
Amortization of Unrealized Holding Gains (Losses) on Investment Securities Held-to-Maturity	$(30)	$333	Interest Income
	12	(131)	Provision for Income Tax
	(18)	202	Net of Tax
Amortization of Defined Benefit Plan Items			
Prior Service Credit [2]	81	81	
Net Actuarial Losses [2]	(443)	(339)	
	(362)	(258)	Total Before Tax
	142	102	Provision for Income Tax
	(220)	(156)	Net of Tax
Total Reclassifications for the Period	$(238)	$46	Net of Tax

[1] Amounts in parentheses indicate reductions to net income.

[2] These accumulated other comprehensive income (loss) components are included in the computation of net periodic benefit cost and are included in Salaries and Benefits on the consolidated statements of income (see Note 10 for additional details).

Note 8. Earnings Per Share

There were no adjustments to net income, the numerator, for purposes of computing earnings per share. The following is a reconciliation of the weighted average number of common shares outstanding for computing diluted earnings per share and antidilutive stock options and restricted stock outstanding for the three months ended March 31, 2015 and 2014:

	Three Months Ended March 31,	
	2015	2014
Denominator for Basic Earnings Per Share	43,386,402	44,193,267
Dilutive Effect of Equity Based Awards	211,102	227,082
Denominator for Diluted Earnings Per Share	43,597,504	44,420,349
Antidilutive Stock Options and Restricted Stock Outstanding	—	862

Note 9. Business Segments

The Company's business segments are defined as Retail Banking, Commercial Banking, Investment Services, and Treasury and Other. The Company's internal management accounting process measures the performance of these business segments. 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 for credit losses, 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 GAAP. Previously reported results have been reclassified to conform to the current reporting structure.

The net interest income of the business segments reflects the results of a funds transfer pricing process that matches assets and liabilities with similar interest rate sensitivity and maturity characteristics and reflects the allocation of net interest income related to the Company's overall asset and liability management activities on a proportionate basis. The basis for the allocation of net interest income is a function of the Company's assumptions that are subject to change based on changes in current interest rates and market conditions. Funds transfer pricing also serves to transfer interest rate risk to Treasury. However, the

27

other business segments have some latitude to retain certain interest rate exposures related to customer pricing decisions within guidelines.

The provision for credit losses reflects the actual net charge-offs of the business segments. The amount of the consolidated provision for loan and lease losses is based on the methodology that we use to estimate our consolidated Allowance. The residual provision for credit losses to arrive at the consolidated provision for credit losses is included in Treasury and Other.

Noninterest income and expense includes allocations from support units to business units. These allocations are based on actual usage where practicably calculated or by management's estimate of such usage.

The provision for income taxes is allocated to business segments using a 37% effective tax rate. However, the provision for income taxes for our Leasing business unit (included in the Commercial Banking segment) and Auto Leasing portfolio and Pacific Century Life Insurance business unit (both included in the Retail Banking segment) are assigned their actual effective tax rates due to the unique relationship that income taxes have with their products. The residual income tax expense or benefit to arrive at the consolidated effective tax rate is included in Treasury and Other.

Retail Banking

Retail Banking offers a broad range of financial products and services to consumers and small businesses. Loan and lease products include residential mortgage loans, home equity lines of credit, automobile loans and leases, personal lines of credit, installment loans, small business loans and leases, and credit cards. Deposit products include checking, savings, and time deposit accounts. Retail Banking also offers retail insurance products. Products and services from Retail Banking are delivered to customers through 74 branch locations and 456 ATMs throughout Hawaii and the Pacific Islands, e-Bankoh (on-line banking service), a 24-hour customer service center, and a mobile banking service.

Commercial Banking

Commercial Banking offers products including corporate banking, commercial real estate loans, commercial lease financing, auto dealer financing, and deposit products. Commercial lending and deposit products are offered to middle-market and large companies in Hawaii and the Pacific Islands. Commercial real estate mortgages focus on customers that include investors, developers, and builders predominantly domiciled in Hawaii. Commercial Banking also includes international banking and provides merchant services to its small business customers.

Investment Services

Investment Services includes private banking, trust services, investment management, and institutional investment advisory services. A significant portion of this segment's income is derived from fees, which are generally based on the market values of assets under management. The private banking and personal trust group assists individuals and families in building and preserving their wealth by providing investment, credit, and trust services to high-net-worth individuals. The investment management group manages portfolios utilizing a variety of investment products. Institutional client services offers investment advice to corporations, government entities, and foundations. This segment also provides a full service brokerage offering equities, mutual funds, life insurance, and annuity products.

Treasury and Other

Treasury consists of corporate asset and liability management activities, including interest rate risk management and a foreign currency exchange business. This segment's assets and liabilities (and related interest income and expense)

consist of interest-bearing deposits, investment securities, federal funds sold and purchased, government deposits, and short and long-term borrowings. The primary sources of noninterest income are from bank-owned life insurance, net gains from the sale of investment securities, and foreign exchange income related to customer-driven currency requests from merchants and island visitors. The net residual effect of the transfer pricing of assets and liabilities is included in Treasury, along with the elimination of intercompany transactions.

Other organizational units (Technology, Operations, Marketing, Human Resources, Finance, Credit and Risk Management, and Corporate and Regulatory Administration) provide a wide-range of support to the Company's other income earning segments. Expenses incurred by these support units are charged to the business segments through an internal cost allocation process.

28

Table of Contents

Selected business segment financial information as of and for the three months ended March 31, 2015 and 2014 were as follows:

(dollars in thousands)	Retail Banking	Commercial Banking	Investment Services	Treasury and Other	Consolidated Total
Three Months Ended March 31, 2015					
Net Interest Income	$48,015	$35,927	$2,977	$9,851	$96,770
Provision for Credit Losses	1,723	(464)	(8)	(1,251)	—
Net Interest Income After Provision for Credit Losses	46,292	36,391	2,985	11,102	96,770
Noninterest Income	19,073	5,599	14,717	12,918	52,307
Noninterest Expense	(50,033)	(18,188)	(14,444)	(4,250)	(86,915)
Income Before Provision for Income Taxes	15,332	23,802	3,258	19,770	62,162
Provision for Income Taxes	(5,447)	(8,402)	(1,205)	(4,666)	(19,720)
Net Income	$9,885	$15,400	$2,053	$15,104	$42,442
Total Assets as of March 31, 2015	$4,239,641	$2,910,258	$188,399	$7,800,881	$15,139,179
Three Months Ended March 31, 2014					
Net Interest Income	$41,102	$28,237	$2,582	$21,312	$93,233
Provision for Credit Losses	1,456	(61)	(68)	(1,327)	—
Net Interest Income After Provision for Credit Losses	39,646	28,298	2,650	22,639	93,233
Noninterest Income	19,320	6,260	14,343	4,845	44,768
Noninterest Expense	(49,096)	(17,418)	(14,235)	(2,798)	(83,547)
Income Before Provision for Income Taxes	9,870	17,140	2,758	24,686	54,454
Provision for Income Taxes	(3,652)	(5,879)	(1,020)	(5,311)	(15,862)
Net Income	$6,218	$11,261	$1,738	$19,375	$38,592
Total Assets as of March 31, 2014	$3,679,909	$2,512,523	$183,381	$7,887,305	$14,263,118

Note 10. Pension Plans and Postretirement Benefit Plan

Components of net periodic benefit cost for the Company’s pension plans and the postretirement benefit plan are presented in the following table for the three months ended March 31, 2015 and 2014.

	Pension Benefits		Postretirement Benefits	
(dollars in thousands)	2015	2014	2015	2014
Three Months Ended March 31,				
Service Cost	$—	$—	$182	$157
Interest Cost	1,186	1,242	324	348
Expected Return on Plan Assets	(1,304)	(1,275)	—	—
Amortization of:				
Prior Service Credit	—	—	(81)	(81)
Net Actuarial Losses (Gains)	443	352	—	(13)
Net Periodic Benefit Cost	$325	$319	$425	$411

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 consolidated statements of income. For the three months ended March 31, 2015, the Company contributed $0.1 million to the pension plans and $0.5 million to the postretirement benefit plan. The Company expects to contribute $0.5 million to the pension plans and $1.4 million to the postretirement benefit plan for the year ending December 31, 2015.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Note 11. Derivative Financial Instruments

The notional amount and fair value of the Company's derivative financial instruments as of March 31, 2015 and December 31, 2014 were as follows:

	March 31, 2015		December 31, 2014	
(dollars in thousands)	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest Rate Lock Commitments	$4,967	$303	$2,354	$152
Forward Commitments	3,777	(7)	5,404	(13)
Interest Rate Swap Agreements				
Receive Fixed/Pay Variable Swaps	175,728	16,152	183,283	16,206
Pay Fixed/Receive Variable Swaps	175,728	(16,185)	183,283	(16,240)
Foreign Exchange Contracts	144	(110)	44,240	(345)

The following table presents the Company’s derivative financial instruments, their fair values, and balance sheet location as of March 31, 2015 and December 31, 2014:

Derivative Financial Instruments	March 31, 2015		December 31, 2014	
Not Designated as Hedging Instruments [1]	Asset	Liability	Asset	Liability
(dollars in thousands)	Derivatives	Derivatives	Derivatives	Derivatives
Interest Rate Lock Commitments	$303	$—	$152	$—
Forward Commitments	1	8	—	13
Interest Rate Swap Agreements	16,152	16,185	16,262	16,296
Foreign Exchange Contracts	17	127	101	446
Total	$16,473	$16,320	$16,515	$16,755

[1] Asset derivatives are included in other assets and liability derivatives are included in other liabilities in the consolidated statements of condition.

The following table presents the Company’s derivative financial instruments and the amount and location of the net gains and losses recognized in the consolidated statements of income for the three months ended March 31, 2015 and 2014:

Derivative Financial Instruments	Location of Net Gains (Losses)	Three Months Ended	
Not Designated as Hedging Instruments	Recognized in the	March 31,	
(dollars in thousands)	Statements of Income	2015	2014
Interest Rate Lock Commitments	Mortgage Banking	$587	$1,101
Forward Commitments	Mortgage Banking	22	(354)
Interest Rate Swap Agreements	Other Noninterest Income	—	4
Foreign Exchange Contracts	Other Noninterest Income	649	799
Total		$1,258	$1,550

Management has received authorization from the Bank’s Board of Directors to use derivative financial instruments as an end-user in connection with the Bank's risk management activities and to accommodate the needs of the Bank's customers. As with any financial instrument, derivative financial instruments have inherent risks. Market risk is defined as the risk of adverse financial impact due to fluctuations in interest rates, foreign exchange rates, and equity prices. Market risks associated with derivative financial instruments are balanced with the expected returns to enhance earnings performance and shareholder value, while limiting the volatility of each. The Company uses various processes to monitor its overall market risk exposure, including sensitivity analysis, value-at-risk calculations, and

other methodologies.

Derivative financial instruments are also subject to credit and counterparty risk, which is defined as the risk of financial loss if a borrower or counterparty is either unable or unwilling to repay borrowings or settle transactions in accordance with the underlying contractual terms. Credit and counterparty risks associated with derivative financial instruments are similar to those relating to traditional financial instruments. The Company manages derivative credit and counterparty risk by evaluating the creditworthiness of each borrower or counterparty, adhering to the same credit approval process used for commercial lending activities.

As of March 31, 2015 and December 31, 2014, the Company did not designate any derivative financial instruments as formal hedging relationships. The Company’s free-standing derivative financial instruments are required to be carried at their fair value on the Company’s consolidated statements of condition. These financial instruments have been limited to interest rate lock commitments (“IRLCs”), forward commitments, interest rate swap agreements, foreign exchange contracts, and conversion rate swap agreements.

---

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

The Company enters into IRLCs for residential mortgage loans which commit us to lend funds to a potential borrower at a specific interest rate and within a specified period of time. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative financial instruments under applicable accounting guidance. Outstanding IRLCs expose the Company to the risk that the price of the mortgage loans underlying the commitments may decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. To mitigate this risk, the Company utilizes forward commitments as economic hedges against the potential decreases in the values of the loans held for sale. IRLCs and forward commitments are free-standing derivatives which are carried at fair value with changes recorded in the mortgage banking component of noninterest income in the Company’s consolidated statements of income.

The Company enters into interest rate swap agreements to facilitate the risk management strategies of a small number of commercial banking customers. The Company mitigates the risk of entering into these agreements by entering into equal and offsetting interest rate swap agreements with highly rated third party financial institutions. The interest rate swap agreements are free-standing derivatives and are recorded at fair value in the Company's consolidated statements of condition. Fair value changes are recorded in other noninterest income in the Company’s consolidated statements of income. The Company is party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes. Collateral, usually in the form of marketable securities, is posted by the counterparty with net liability positions in accordance with contract thresholds. See Note 6 to the Consolidated Financial Statements for more information.

The Company’s interest rate swap agreements with institutional counterparties contain credit-risk-related contingent features tied to the Company’s debt ratings or capitalization levels. Under these provisions, if the Company’s debt rating falls below investment grade or if the Company’s capitalization levels fall below stipulated thresholds, certain counterparties may require immediate and ongoing collateralization on interest rate swaps in net liability positions, or may require immediate settlement of the contracts. As of March 31, 2015, the Company’s debt ratings and capital levels were in excess of these minimum requirements.

The Company utilizes foreign exchange contracts to offset risks related to transactions executed on behalf of customers. The foreign exchange contracts are free-standing derivatives which are carried at fair value with changes included in other noninterest income in the Company’s consolidated statements of income.

Whenever the Company sells Visa Class B restricted shares, the Company enters into a conversion rate swap agreement with the buyer that requires payment to the buyer in the event Visa further reduces the conversion ratio of Class B into Class A unrestricted common shares. In the event of Visa increasing the conversion ratio, the buyer would be required to make payment to the Company. This conversion rate swap agreement is usually valued at zero (i.e., no contingent liability recorded) as a drop in the conversion ratio is deemed by the Company to be neither probable nor reasonably estimable. However, in September 2014, Visa announced a reduction of the conversion ratio. As a result, the Company recorded a $0.1 million liability in September 2014 which represented the amount paid to the buyer in October 2014. As of March 31, 2015, the conversion rate swap agreement was valued at zero as further reductions to the conversion ratio were deemed neither probable nor reasonably estimable by management. See Note 2 to the Consolidated Financial Statements for more information.

Note 12. Commitments, Contingencies, and Guarantees

The Company’s credit commitments as of March 31, 2015 and December 31, 2014 were as follows:

(dollars in thousands)	March 31, 2015	December 31, 2014
Unfunded Commitments to Extend Credit	$2,439,684	$2,388,432

Standby Letters of Credit	46,812	48,157
Commercial Letters of Credit	17,327	14,130
Total Credit Commitments	$2,503,823	$2,450,719

Unfunded Commitments to Extend Credit

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of the terms or conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since commitments may expire without being drawn, the total commitment amount does not necessarily represent future cash requirements.

---

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

Standby and Commercial Letters of Credit

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally become payable upon the failure of the customer to perform according to the terms of the underlying contract with the third party, while commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and a third party. The contractual amount of these letters of credit represents the maximum potential future payments guaranteed by the Company. The Company has recourse against the customer for any amount it is required to pay to a third party under a standby letter of credit, and generally holds cash or deposits as collateral on those standby letters of credit for which collateral is deemed necessary.

Contingencies

The Company is subject to various pending and threatened legal proceedings arising out of the normal course of business or operations. On at least a quarterly basis, the Company assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the most recent information available. On a case-by-case basis, reserves are established for those legal claims for which it is probable that a loss will be incurred and the amount of such loss can be reasonably estimated. Based on information currently available, management believes that the eventual outcome of these other actions against the Company will not be materially in excess of such amounts accrued by the Company. However, in the event of unexpected future developments, it is possible that the ultimate resolution of those matters may result in a loss that materially exceeds the reserves established by the Company.

Risks Related to Representation and Warranty Provisions

The Company sells residential mortgage loans in the secondary market primarily to the Federal National Mortgage Association ("Fannie Mae"). The Company also pools Federal Housing Administration (“FHA”) insured and U.S. Department of Veterans Affairs (“VA”) guaranteed residential mortgage loans for sale to the Government National Mortgage Corporation ("Ginnie Mae"). These pools of FHA-insured and VA-guaranteed residential mortgage loans are securitized by Ginnie Mae. The agreements under which the Company sells residential mortgage loans to Fannie Mae or Ginnie Mae and the insurance or guaranty agreements with FHA and VA contain provisions that include various representations and warranties regarding the origination and characteristics of the residential mortgage loans. Although the specific representations and warranties vary among investors, insurance or guarantee agreements, they typically cover ownership of the loan, validity of the lien securing the loan, the absence of delinquent taxes or liens against the property securing the loan, compliance with loan criteria set forth in the applicable agreement, compliance with applicable federal, state, and local laws, and other matters. As of March 31, 2015, the unpaid principal balance of residential mortgage loans sold by the Company was $2.7 billion. The agreements under which the Company sells residential mortgage loans require delivery of various documents to the investor or its document custodian. Although these loans are primarily sold on a non-recourse basis, the Company may be obligated to repurchase residential mortgage loans or reimburse investors for losses incurred if a loan review reveals that underwriting and documentation standards were potentially not met. Upon receipt of a repurchase request, the Company works with investors or insurers to arrive at a mutually agreeable resolution. Repurchase demands are typically reviewed on an individual loan by loan basis to validate the claims made by the investor or insurer and to determine if a contractually required repurchase event has occurred. The Company manages the risk associated with potential repurchases or other forms of settlement through its underwriting and quality assurance practices and by servicing mortgage loans to meet investor and secondary market standards. For the three months ended March 31, 2015, there were no residential mortgage loans repurchased as a result of the representation and warranty provisions contained in these contracts. As of March 31, 2015, there was one pending repurchase request for $0.3 million related to representation and warranty provisions.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Risks Relating to Residential Mortgage Loan Servicing Activities

In addition to servicing loans in the Company's portfolio, substantially all of the loans the Company sells to investors are sold with servicing rights retained. The Company also services loans originated by other mortgage loan originators. As servicer, the Company's primary duties are to: (1) collect payments due from borrowers; (2) advance certain delinquent payments of principal and interest; (3) maintain and administer any hazard, title, or primary mortgage insurance policies relating to the mortgage loans; (4) maintain any required escrow accounts for payment of taxes and insurance and administer escrow payments; and (5) foreclose on defaulted mortgage loans or, to the extent consistent with the documents governing a securitization, consider alternatives to foreclosure, such as loan modifications or short sales. Each agreement under which the Company acts as servicer generally specifies a standard of responsibility for actions taken by the Company in such capacity and provides protection against expenses and liabilities incurred by the Company when acting in compliance with the respective servicing agreements. However, if the Company commits a material breach of obligations as servicer, the Company may be

subject to termination if the breach is not cured within a specified period following notice. The standards governing servicing and the possible remedies for violations of such standards vary by investor. These standards and remedies are determined by servicing guides issued by the investors as well as the contract provisions established between the investors and the Company. Remedies could include repurchase of an affected loan. For the three months ended March 31, 2015, there were no loans repurchased related to loan servicing activities. As of March 31, 2015, there were no pending repurchase requests related to loan servicing activities.

Although to date repurchase requests related to representation and warranty provisions and servicing activities have been limited, it is possible that requests to repurchase mortgage loans may increase in frequency as investors more aggressively pursue all means of recovering losses on their purchased loans. However, as of March 31, 2015, management believes that this exposure is not material due to the historical level of repurchase requests and loss trends and thus has not established a liability for losses related to mortgage loan repurchases. As of March 31, 2015, 99% of the Company's residential mortgage loans serviced for investors were current. The Company maintains ongoing communications with investors and continues to evaluate this exposure by monitoring the level and number of repurchase requests as well as the delinquency rates in the loans sold to investors.

Note 13. Fair Value of Assets and Liabilities

Fair Value Hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. GAAP established a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

Level 1:	Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and is used to measure fair value whenever available. A contractually binding sales price also provides reliable evidence of fair value.
Level 2:	Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that utilize model-based techniques for which all significant assumptions are observable in the market.
Level 3:	Inputs to the valuation methodology are unobservable and significant to the fair value measurement; inputs to the valuation methodology that utilize model-based techniques for which significant assumptions are not observable in the market; or inputs to the valuation methodology that require significant management judgment or estimation, some of which may be internally developed.

Management maximizes the use of observable inputs and minimizes the use of unobservable inputs when determining fair value measurements. Management reviews and updates the fair value hierarchy classifications of the Company’s assets and liabilities on a quarterly basis.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Investment Securities Available-for-Sale

Fair values of investment securities available-for-sale were primarily measured using information from a third-party pricing service. This service provides pricing information by utilizing evaluated pricing models supported with market data information. Standard inputs include benchmark yields, reported trades, broker/dealer quotes, issuer

spreads, two-sided markets, benchmark securities, bids, offers, and reference data from market research publications. Level 1 investment securities are comprised of debt securities issued by the U.S. Treasury. As quoted prices were available, unadjusted, for identical securities in active markets, these securities were classified as Level 1 measurements. Level 2 investment securities were primarily comprised of debt securities issued by the Small Business Administration, states and municipalities, corporations, as well as mortgage-backed securities issued by government agencies and government-sponsored enterprises. Fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models. In cases where there may be limited or less transparent information provided by the Company's third-party

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

pricing service, fair value may be estimated by the use of secondary pricing services or through the use of non-binding third-party broker quotes.

On a quarterly basis, management reviews the pricing information received from the Company's third-party pricing service. This review process includes a comparison to non-binding third-party broker quotes, as well as a review of market-related conditions impacting the information provided by the Company's third-party pricing service. Management primarily identifies investment securities which may have traded in illiquid or inactive markets by identifying instances of a significant decrease in the volume or frequency of trades relative to historical levels, as well as instances of a significant widening of the bid-ask spread in the brokered markets. Investment securities that are deemed to have been trading in illiquid or inactive markets may require the use of significant unobservable inputs to determine fair value. As of March 31, 2015 and December 31, 2014, management did not make adjustments to prices provided by the third-party pricing service as a result of illiquid or inactive markets. On a quarterly basis, management also reviews a sample of securities priced by the Company's third-party pricing service to review significant assumptions and valuation methodologies used. Based on this review, management determines whether the current placement of the security in the fair value hierarchy is appropriate or whether transfers may be warranted. The Company's third-party pricing service has also established processes for us to submit inquiries regarding quoted prices. Periodically, we will challenge the quoted prices provided by our third-party pricing service. The Company's third-party pricing service will review the inputs to the evaluation in light of the new market data presented by us. The Company's third-party pricing service may then affirm the original quoted price or may update the evaluation on a going forward basis.

Loans Held for Sale

The fair value of the Company's residential mortgage loans held for sale was determined based on quoted prices for similar loans in active markets, and therefore, is classified as a Level 2 measurement.

Mortgage Servicing Rights

Mortgage servicing rights do not trade in an active market with readily observable market data. As a result, the Company estimates the fair value of mortgage servicing rights by using a discounted cash flow model to calculate the present value of estimated future net servicing income. The Company stratifies its mortgage servicing portfolio on the basis of loan type. The assumptions used in the discounted cash flow model are those that we believe market participants would use in estimating future net servicing income. Significant assumptions in the valuation of mortgage servicing rights include estimated loan repayment rates, the discount rate, servicing costs, and the timing of cash flows, among other factors. Mortgage servicing rights are classified as Level 3 measurements due to the use of significant unobservable inputs, as well as significant management judgment and estimation.

Other Assets

Other assets recorded at fair value on a recurring basis are primarily comprised of investments related to deferred compensation arrangements. Quoted prices for these investments, primarily in mutual funds, are available in active markets. Thus, the Company's investments related to deferred compensation arrangements are classified as Level 1 measurements in the fair value hierarchy.

Derivative Financial Instruments

Derivative financial instruments recorded at fair value on a recurring basis are comprised of interest rate lock commitments ("IRLCs"), forward commitments, interest rate swap agreements, foreign exchange contracts, and Visa Class B to Class A shares conversion rate swap agreements. The fair values of IRLCs are calculated based on the

value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a locked position will ultimately close. This factor, the closing ratio, is derived from the Bank's internal data and is adjusted using significant management judgment. As such, IRLCs are classified as Level 3 measurements. Forward commitments are classified as Level 2 measurements as they are primarily based on quoted prices from the secondary market based on the settlement date of the contracts, interpolated or extrapolated, if necessary, to estimate a fair value as of the end of the reporting period. The fair values of interest rate swap agreements are calculated using a discounted cash flow approach and utilize Level 2 observable inputs such as the LIBOR swap curve, effective date, maturity date, notional amount, and stated interest rate. In addition, the Company includes in its fair value calculation a credit factor adjustment which is based primarily on management judgment. Thus, interest rate swap agreements are classified as a Level 3 measurement. The fair values of foreign exchange contracts are calculated using the Bank's multi-currency accounting system which utilizes contract specific information such as currency, maturity date, contractual amount, and strike price, along with market data information such as the spot rates of specific currency and yield curves. Foreign exchange contracts are classified

---

Table of Contents

as Level 2 measurements because while they are valued using the Bank's multi-currency accounting system, significant management judgment or estimation is not required. The fair value of the Visa Class B restricted shares to Class A unrestricted common shares conversion rate swap agreement represents the amount owed by the Company to the buyer of the Visa Class B shares as a result of a reduction of the conversion ratio subsequent to the sales dates. As of March 31, 2015 and December 31, 2014, the conversion rate swap agreement was valued at zero as reductions to the conversion ratio were neither probable nor reasonably estimable by management. This conversion rate swap agreement is classified as a Level 2 measurement. See Note 11 to the Consolidated Financial Statements for more information.

The Company is exposed to credit risk if borrowers or counterparties fail to perform. The Company seeks to minimize credit risk through credit approvals, limits, monitoring procedures, and collateral requirements. The Company generally enters into transactions with borrowers and counterparties that carry high quality credit ratings. Credit risk associated with borrowers or counterparties as well as the Company's non-performance risk is factored into the determination of the fair value of derivative financial instruments.

35

Table of Contents

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis as of March 31, 2015 and December 31, 2014:

(dollars in thousands)	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
March 31, 2015				
Assets:				
Investment Securities Available-for-Sale				
Debt Securities Issued by the U.S. Treasury and Government Agencies	$61,106	$294,545	$—	$355,651
Debt Securities Issued by States and Political Subdivisions	—	752,468	—	752,468
Debt Securities Issued by Corporations	—	285,945	—	285,945
Mortgage-Backed Securities:				
Residential - Government Agencies	—	427,391	—	427,391
Residential - U.S. Government-Sponsored Enterprises	—	283,574	—	283,574
Commercial - Government Agencies	—	166,157	—	166,157
Total Mortgage-Backed Securities	—	877,122	—	877,122
Total Investment Securities Available-for-Sale	61,106	2,210,080	—	2,271,186
Loans Held for Sale	—	1,951	—	1,951
Mortgage Servicing Rights	—	—	2,277	2,277
Other Assets	19,577	—	—	19,577
Derivatives [1]	—	18	16,455	16,473
Total Assets Measured at Fair Value on a Recurring Basis as of March 31, 2015	$80,683	$2,212,049	$18,732	$2,311,464
Liabilities:				
Derivatives [1]	$—	$135	$16,185	$16,320
Total Liabilities Measured at Fair Value on a Recurring Basis as of March 31, 2015	$—	$135	$16,185	$16,320
December 31, 2014				
Assets:				
Investment Securities Available-for-Sale				
Debt Securities Issued by the U.S. Treasury and Government Agencies	$61,271	$269,987	$—	$331,258
Debt Securities Issued by States and Political Subdivisions	—	743,970	—	743,970
Debt Securities Issued by Corporations	—	294,833	—	294,833
Mortgage-Backed Securities:				
Residential - Government Agencies	—	462,436	—	462,436
Residential - U.S. Government-Sponsored Enterprises	—	278,461	—	278,461
Commercial - Government Agencies	—	178,232	—	178,232

Total Mortgage-Backed Securities	—	919,129	—	919,129
Total Investment Securities Available-for-Sale	61,271	2,227,919	—	2,289,190
Loans Held for Sale	—	5,136	—	5,136
Mortgage Servicing Rights	—	—	2,604	2,604
Other Assets	18,794	—	—	18,794
Derivatives [1]	—	101	16,414	16,515
Total Assets Measured at Fair Value on a Recurring Basis as of December 31, 2014	$80,065	$2,233,156	$19,018	$2,332,239
Liabilities:				
Derivatives [1]	$—	$459	$16,296	$16,755
Total Liabilities Measured at Fair Value on a Recurring Basis as of December 31, 2014	$—	$459	$16,296	$16,755

[1] The fair value of each class of derivatives is shown in Note 11 to the Consolidated Financial Statements.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

For the three months ended March 31, 2015 and 2014, the changes in Level 3 assets and liabilities measured at fair value on a recurring basis were as follows:

(dollars in thousands)	Mortgage Servicing Rights [1]	Net Derivative Assets and Liabilities [2]
Three Months Ended March 31, 2015		
Balance as of January 1, 2015	$2,604	$118
Realized and Unrealized Net Gains (Losses):		
Included in Net Income	(327)	587
Transfers to Loans Held for Sale	—	(435)
Balance as of March 31, 2015	$2,277	$270
Total Unrealized Net Gains (Losses) Included in Net Income Related to Assets Still Held as of March 31, 2015	$(251)	$270
Three Months Ended March 31, 2014		
Balance as of January 1, 2014	$3,826	$379
Realized and Unrealized Net Gains (Losses):		
Included in Net Income	(445)	1,104
Transfers to Loans Held for Sale	—	(1,194)
Balance as of March 31, 2014	$3,381	$289
Total Unrealized Net Gains (Losses) Included in Net Income Related to Assets Still Held as of March 31, 2014	$(349)	$289

[1] Realized and unrealized gains and losses related to mortgage servicing rights are reported as a component of mortgage banking income in the Company's consolidated statements of income.

[2] Realized and unrealized gains and losses related to interest rate lock commitments are reported as a component of mortgage banking income in the Company's consolidated statements of income. Realized and unrealized gains and losses related to interest rate swap agreements are reported as a component of other noninterest income in the Company's consolidated statements of income.

For Level 3 assets and liabilities measured at fair value on a recurring or nonrecurring basis as of March 31, 2015 and December 31, 2014, the significant unobservable inputs used in the fair value measurements were as follows:

(dollars in thousands)	Valuation Technique	Significant Unobservable Inputs (weighted-average) Description	Mar. 31, 2015	Dec. 31, 2014	Fair Value Mar. 31, 2015	Fair Value Dec. 31, 2014
Mortgage Servicing Rights	Discounted Cash Flow	Constant Prepayment Rate [1]	12.96%	11.62%	$23,708	$25,441
		Discount Rate [2]	10.32%	10.61%		
Net Derivative Assets and Liabilities:						
Interest Rate Lock Commitments	Pricing Model	Closing Ratio	93.42%	93.85%	$303	$152
Interest Rate Swap Agreements	Discounted Cash Flow	Credit Factor	0.21%	0.21%	$(33)	$(34)

[1] Represents annualized loan repayment rate assumption.

[2] Derived from multiple interest rate scenarios that incorporate a spread to the London Interbank Offered Rate swap curve and market volatilities.

The significant unobservable inputs used in the fair value measurement of the Company's mortgage servicing rights are the weighted-average constant prepayment rate and weighted-average discount rate. Significant increases (decreases) in any of those inputs in isolation could result in a significantly lower (higher) fair value measurement. Although the constant prepayment rate and the discount rate are not directly interrelated, they generally move in opposite directions of each other.

The Company estimates the fair value of mortgage servicing rights by using a discounted cash flow model to calculate the present value of estimated future net servicing income. The Company's Treasury Division enters observable and unobservable inputs into the model to arrive at an estimated fair value. To assess the reasonableness of the fair value measurement, the Treasury Division performs a back-test by applying the model to historical prepayment data. The fair value and constant prepayment rate are also compared to forward-looking estimates to assess reasonableness. The Treasury Division also compares the fair value of the Company's mortgage servicing rights to a value calculated by an independent third party. Discussions are held with members from the Treasury, Mortgage Banking, and Controllers Divisions, along with the independent third party to discuss and reconcile the fair value estimates and key assumptions used by the respective parties in arriving at those estimates. A subcommittee of the Company's Asset/Liability Management Committee is responsible for providing oversight over the valuation methodology and key assumptions.

---

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

The significant unobservable input used in the fair value measurement of the Company's IRLCs is the closing ratio, which represents the percentage of loans currently in a lock position which management estimates will ultimately close. Generally, the fair value of an IRLC is positive (negative) if the prevailing interest rate is lower (higher) than the IRLC rate. Therefore, an increase in the closing ratio (i.e., higher percentage of loans are estimated to close) will increase the gain or loss. The closing ratio is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. The closing ratio is computed by our secondary marketing system using historical data and the ratio is periodically reviewed by the Company's Secondary Marketing Department of the Mortgage Banking Division for reasonableness.

The unobservable input used in the fair value measurement of the Company's interest rate swap agreements is the credit factor. This factor represents the risk that a counterparty is either unable or unwilling to settle a transaction in accordance with the underlying contractual terms. A significant increase (decrease) in the credit factor could result in a significantly lower (higher) fair value measurement. The credit factor is determined by the Treasury Division based on the risk rating assigned to each counterparty in which the Company holds a net asset position. The Company's Credit Policy Committee periodically reviews and approves the Expected Default Frequency of the Economic Capital Model for Credit Risk. The Expected Default Frequency is used as the credit factor for interest rate swap agreements.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required periodically to measure certain assets and liabilities at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from the application of lower-of-cost-or-fair value accounting or impairment write-downs of individual assets. The following table represents the assets measured at fair value on a nonrecurring basis as of March 31, 2015 and December 31, 2014.

(dollars in thousands)	Fair Value Hierarchy	Net Carrying Amount	Valuation Allowance
March 31, 2015			
Mortgage Servicing Rights - amortization method	Level 3	$21,366	$77
Foreclosed Real Estate	Level 3	2,095	354
December 31, 2014			
Mortgage Servicing Rights - amortization method	Level 3	$22,091	$57
Foreclosed Real Estate	Level 3	2,311	89

The write-down of mortgage servicing rights was primarily due to changes in certain key assumptions used to estimate fair value. As previously mentioned, all of the Company's mortgage servicing rights are classified as Level 3 measurements due to the use of significant unobservable inputs, as well as significant management judgment and estimation. In addition, the Company's foreclosed real estate was reduced by an impairment charge related to the Company's revised fair value estimate, deemed a Level 3 measurement, of one commercial property based on a recent appraisal and management judgment.

Fair Value Option

The Company elected the fair value option for all residential mortgage loans held for sale originated on or after October 1, 2011. This election allows for a more effective offset of the changes in fair values of the loans held for sale and the derivative financial instruments used to financially hedge them without having to apply complex hedge accounting requirements. As noted above, the fair value of the Company's residential mortgage loans held for sale was determined based on quoted prices for similar loans in active markets.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

The following table reflects the difference between the aggregate fair value and the aggregate unpaid principal balance of the Company's residential mortgage loans held for sale as of March 31, 2015 and December 31, 2014.

(dollars in thousands)	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
March 31, 2015			
Loans Held for Sale	$1,951	$ 1,831	$ 120
December 31, 2014			
Loans Held for Sale	$5,136	$ 4,740	$ 396

Changes in the estimated fair value of residential mortgage loans held for sale are reported as a component of mortgage banking income in the Company's consolidated statements of income. For the three months ended March 31, 2015 and 2014, the net gains or losses from the change in fair value of the Company's residential mortgage loans held for sale were not material.

Financial Instruments Not Recorded at Fair Value on a Recurring Basis

The assumptions used below are expected to approximate those that market participants would use in valuing these financial instruments.

Investment Securities Held-to-Maturity

The fair value of the Company's investment securities held-to-maturity was primarily measured using information from a third-party pricing service. Level 1 investment securities are comprised of debt securities issued by the U.S. Treasury as quoted prices were available, unadjusted, for identical securities in active markets. If quoted prices were not available, fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models. In cases where there may be limited or less transparent information provided by the Company's third-party pricing service, fair value may be estimated by the use of secondary pricing services or through the use of non-binding third-party broker quotes.

Loans

The fair value of the Company's loans was estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loans were first segregated by type such as commercial, real estate, and consumer, and were then further segmented into fixed and variable rate and loan quality categories. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments.

Time Deposits

The fair values of the Company's time deposits were estimated using discounted cash flow analyses. The discount rates used were based on rates currently offered for deposits with similar remaining maturities. The fair values of the Company's time deposit liabilities do not take into consideration the value of the Company's long-term relationships with depositors, which may have significant value.

Securities Sold Under Agreements to Repurchase

The fair value of the Company's securities sold under agreements to repurchase was calculated using discounted cash flow analyses, applying discount rates currently offered for new agreements with similar remaining maturities and

considering the Company's non-performance risk.

Other Debt

The fair value of the Company's other debt was calculated using a discounted cash flow approach and applying discount rates currently offered for new notes with similar remaining maturities and considering the Company's non-performance risk.

---

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments not recorded at fair value on a recurring basis as of March 31, 2015 and December 31, 2014. This table excludes financial instruments for which the carrying amount approximates fair value. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For non-marketable equity securities such as Federal Home Loan Bank and Federal Reserve Bank stock, the carrying amount is a reasonable estimate of fair value as these securities can only be redeemed or sold at their par value and only to the respective issuing government supported institution or to another member institution. For financial liabilities such as noninterest-bearing demand, interest-bearing demand, and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity.

			Fair Value Measurements		
(dollars in thousands)	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2015					
Financial Instruments - Assets					
Investment Securities Held-to-Maturity	$4,306,353	$4,378,007	$523,372	$3,854,635	$ —
Loans [1]	6,825,344	7,373,867	—	—	7,373,867
Financial Instruments - Liabilities					
Time Deposits	1,308,932	1,312,619	—	1,312,619	—
Securities Sold Under Agreements to Repurchase	672,329	744,649	—	744,649	—
Other Debt [2]	163,005	164,269	—	164,269	—
December 31, 2014					
Financial Instruments - Assets					
Investment Securities Held-to-Maturity	$4,466,679	$4,504,495	$499,616	$4,004,879	$ —
Loans [1]	6,542,719	7,048,757	—	—	7,048,757
Financial Instruments - Liabilities					
Time Deposits	1,434,001	1,437,064	—	1,437,064	—
Securities Sold Under Agreements to Repurchase	688,601	758,781	—	758,781	—
Other Debt [2]	163,005	163,911	—	163,911	—

[1] Net of unearned income and the Allowance.
[2] Excludes capitalized lease obligations.

Table of Contents

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

Forward-Looking Statements

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements can be identified by the fact that they do not relate strictly to historical or current facts and may include statements concerning, among other things, the anticipated economic and business environment in our service area and elsewhere, credit quality and other financial and business matters in future periods, our future results of operations and financial position, our business strategy and plans and our objectives and future operations. We also may make forward-looking statements in our other documents filed or furnished with the Securities and Exchange Commission. In addition, our senior management may make forward-looking statements orally to analysts, investors, representatives of the media and others.
Our forward-looking statements are based on numerous assumptions, any of which could prove to be inaccurate and actual results may differ materially from those projected because of a variety of risks and uncertainties, including, but not limited to: 1) general economic conditions either nationally, internationally, or locally may be different than expected, and particularly, any event that negatively impacts the tourism industry in Hawaii; 2) unanticipated changes in the securities markets, public debt markets, and other capital markets in the U.S. and internationally; 3) competitive pressures in the markets for financial services and products; 4) the impact of legislative and regulatory initiatives, particularly the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"); 5) changes in fiscal and monetary policies of the markets in which we operate; 6) the increased cost of maintaining or the Company's ability to maintain adequate liquidity and capital, based on the requirements adopted by the Basel Committee on Banking Supervision and U.S. regulators; 7) actual or alleged conduct which could harm our reputation; 8) changes in accounting standards; 9) changes in tax laws or regulations or the interpretation of such laws and regulations; 10) changes in our credit quality or risk profile that may increase or decrease the required level of our reserve for credit losses; 11) changes in market interest rates that may affect credit markets and our ability to maintain our net interest margin; 12) the impact of litigation and regulatory investigations of the Company, including costs, expenses, settlements, and judgments; 13) any failure in or breach of our operational systems, information systems or infrastructure, or those of our merchants, third party vendors and other service providers; 14) any interruption or breach of security of our information systems resulting in failures or disruptions in customer account management, general ledger processing, and loan or deposit systems; 15) changes to the amount and timing of proposed common stock repurchases; and 16) natural disasters, public unrest or adverse weather, public health, and other conditions impacting us and our customers' operations. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included under the section entitled "Risk Factors" in Part II of this report and Part I of our Annual Report on Form 10-K for the year ended December 31, 2014, and subsequent periodic and current reports filed with the U.S. Securities and Exchange Commission (the "SEC"). Words such as "believes," "anticipates," "expects," "intends," "targeted," a similar expressions are intended to identify forward-looking statements but are not exclusive means of identifying such statements. We undertake no obligation to update forward-looking statements to reflect later events or circumstances.

Overview

Bank of Hawaii Corporation (the "Parent") is a Delaware corporation and a bank holding company headquartered in Honolulu, Hawaii. The Parent's principal operating subsidiary is Bank of Hawaii (the "Bank").

The Bank, directly and through its subsidiaries, provides a broad range of financial services and products to businesses, consumers, and governments in Hawaii, Guam, and other Pacific Islands. References to "we," "our," "us," or the "Company" refer to the Parent and its subsidiaries that are consolidated for financial reporting purposes.

Our business strategy is to use our unique market knowledge, prudent management discipline and brand strength to deliver exceptional value to our stakeholders.

Hawaii Economy

General economic conditions in Hawaii remained positive during the first quarter of 2015 led by a strong tourism industry, expanding construction activity, relatively low unemployment, and rising real estate prices. For the first two months of 2015, total visitor arrivals increased 0.8% while total visitor spending decreased 3.3% compared to the same period in 2014. Following another record level of tourism in 2014, the current level of visitor activity still reflects a healthy tourism industry despite the mixed year-to-date results. The statewide seasonally-adjusted unemployment rate was at 4.1% in February 2015, compared to 5.5% nationally. Real estate prices on Oahu continue to rise even as the number of sales declined mainly due to limited inventory of available properties on the market. For the first three months of 2015, the volume of single-family home

sales on Oahu decreased 4.0%, while the volume of condominium sales on Oahu decreased 1.4% compared with the same period in 2014. The median price of single-family home sales and condominium sales on Oahu increased 3.2% and 5.4%, respectively, for the first three months of 2015 compared to the same period in 2014. As of March 31, 2015, months of inventory of single-family homes and condominiums on Oahu remained low at 2.7 months and 3.4 months, respectively.

Earnings Summary

Net income for the first quarter of 2015 was $42.4 million, an increase of $3.9 million or 10% compared to the same period in 2014. Diluted earnings per share was $0.97 for the first quarter of 2015, an increase of $0.10 or 11% compared to the same period in 2014.

Our higher earnings for the first quarter of 2015 were primarily due to the following:

- Net interest income for the first quarter of 2015 was $96.8 million, an increase of $3.5 million or 4% compared to the same period in 2014. Our net interest margin was 2.81% in the first quarter of 2015, a decrease of 6 basis points compared to the same period in 2014. The decrease was primarily due to lower yields in our investment securities and loans, reflective of the current low interest rate environment.
- Net gains on sales of investment securities totaled $10.2 million in the first quarter of 2015 compared to $2.2 million during the same period in 2014. The net gain in the first quarter of 2015 was primarily due to a $10.1 million gain on the sale of 95,000 Visa Class B shares. The net gain in the first quarter of 2014 was primarily due to a $2.0 million gain on the sale of 22,000 Visa Class B shares. The sale of Visa Class B shares was larger in the current quarter due to our new counterparty's minimum transaction requirement. We do not currently anticipate further sales of Visa Class B shares during 2015. The Company received these Class B shares in 2008 as part of Visa's initial public offering and are transferable only under limited circumstances until they can be converted to the publicly traded Class A shares. We also contributed to the Bank of Hawaii Foundation 4,700 and 5,500 Visa Class B shares during the first quarters of 2015 and 2014, respectively. These contributions had no impact on noninterest expense; however, these contributions favorably impacted our effective tax rate.

These items were partially offset by the following:

- Salaries and benefits expense for the first quarter of 2015 was $49.8 million, an increase of $2.9 million or 6% compared to the same period in 2014 primarily due to a $1.4 million increase in separation expense and a $0.6 million increase in medical, dental, and life insurance expense. In addition, commission expense increased by $0.5 million primarily due to an increase in both loan origination and refinance activity.
- Provision for income taxes for the first quarter of 2015 was $19.7 million, an increase of $3.9 million or 24% compared to the same period in 2014 primarily due to higher pretax income and a higher effective income tax rate mainly resulting from the release of reserves in the first quarter of 2014 due to a settlement with the State of Hawaii related to prior year tax issues.

We continued our focus on maintaining a strong balance sheet during the first quarter of 2015, with adequate reserves for credit losses, and high levels of liquidity and capital. In particular:

- Total loans and leases were $7.2 billion as of March 31, 2015, an increase of $281.0 million or 4% from December 31, 2014 primarily due to growth in our commercial lending portfolio and residential mortgage portfolio.
- The allowance for loan and lease losses (the "Allowance") was $107.5 million as of March 31, 2015, a decrease of $1.2 million or 1% from December 31, 2014. The Allowance represents 1.50% of total loans and leases outstanding as of March 31, 2015 and 1.58% of total loans and leases outstanding as of December 31, 2014. The decrease was commensurate with the Company's credit risk profile, loan portfolio growth and composition, and a healthy Hawaii economy.
- As of March 31, 2015, the total carrying value of our investment securities portfolio was $6.6 billion, a decrease of $178.3 million or 3% compared to December 31, 2014. During the first three months of 2015, we continued to reduce our positions in mortgage-backed securities issued by Ginnie Mae. We re-invested these proceeds primarily into

higher yielding loan products. In addition, we increased our holdings in Small Business Administration securities and U.S. Treasury notes.

- Total deposits were $13.0 billion as of March 31, 2015, an increase of $346.5 million or 3% from December 31, 2014 primarily due to an increase in core deposits.

42

Table of Contents

Total shareholders' equity was $1.1 billion as of March 31, 2015, an increase of $20.2 million or 2% from December 31, 2014. We continued to return capital to our shareholders in the form of share repurchases and dividends. During the first three months of 2015, we repurchased 227,226 shares of our common stock at a total cost of $13.1 million under our share repurchase program and from shares purchased from employees and/or directors in connection with stock swaps, income tax withholdings related to the vesting of restricted stock, and shares purchased for a deferred compensation plan. We also paid cash dividends of $19.7 million during the first three months of 2015.

Table of Contents

Our financial highlights are presented in Table 1.

Financial Highlights Table 1

(dollars in thousands, except per share amounts)	Three Months Ended March 31, 2015	2014
For the Period:		
Operating Results		
Net Interest Income	$96,770	$93,233
Provision for Credit Losses	—	—
Total Noninterest Income	52,307	44,768
Total Noninterest Expense	86,915	83,547
Net Income	42,442	38,592
Basic Earnings Per Share	0.98	0.87
Diluted Earnings Per Share	0.97	0.87
Dividends Declared Per Share	0.45	0.45
Performance Ratios		
Return on Average Assets	1.15 %	1.12 %
Return on Average Shareholders' Equity	16.18	15.15
Efficiency Ratio [1]	58.30	60.54
Net Interest Margin [2]	2.81	2.87
Dividend Payout Ratio [3]	45.92	51.72
Average Shareholders' Equity to Average Assets	7.12	7.36
Average Balances		
Average Loans and Leases	$7,053,061	$6,104,041
Average Assets	14,946,037	14,033,949
Average Deposits	12,786,449	11,814,548
Average Shareholders' Equity	1,064,112	1,033,413
Market Price Per Share of Common Stock		
Closing	$61.21	$60.61
High	62.58	61.36
Low	53.90	54.16
	March 31, 2015	December 31, 2014
As of Period End:		
Balance Sheet Totals		
Loans and Leases	$7,178,628	$6,897,589
Total Assets	15,139,179	14,787,208
Total Deposits	12,979,616	12,633,089
Other Debt	173,898	173,912
Total Shareholders' Equity	1,075,251	1,055,086
Asset Quality		
Non-Performing Assets	28,777	30,082
Allowance for Loan and Lease Losses	$107,461	$108,688
Allowance to Loans and Leases Outstanding	1.50 %	1.58 %

Capital Ratios				
Common Equity Tier 1 Capital Ratio [4]	14.62	%	n/a	
Tier 1 Capital Ratio [4]	14.62		14.69	%
Total Capital Ratio [4]	15.87		15.94	
Tier 1 Leverage Ratio [4]	7.17		7.13	
Total Shareholders' Equity to Total Assets	7.10		7.14	
Tangible Common Equity to Tangible Assets [5]	6.91		6.94	
Tangible Common Equity to Risk-Weighted Assets [4, 5]	14.27		14.46	
Non-Financial Data				
Full-Time Equivalent Employees	2,156		2,161	
Branches	74		74	
ATMs	456		459	

[1] Efficiency ratio is defined as noninterest expense divided by total revenue (net interest income and total noninterest income).

[2] Net interest margin is defined as net interest income, on a taxable-equivalent basis, as a percentage of average earning assets.

[3] Dividend payout ratio is defined as dividends declared per share divided by basic earnings per share.

[4] March 31, 2015 calculated under Basel III rules, which became effective January 1, 2015.

[5] Tangible common equity to tangible assets and tangible common equity to risk-weighted assets are Non-GAAP financial measures. See the "Use of Non-GAAP Financial Measures" section below.

44

Table of Contents

Use of Non-GAAP Financial Measures

The ratios “tangible common equity to tangible assets” and “tangible common equity to risk-weighted assets” are Non-GAAP financial measures. The Company believes these measurements are useful for investors, regulators, management and others to evaluate capital adequacy relative to other financial institutions. Although these Non-GAAP financial measures are frequently used by stakeholders in the evaluation of a financial institution, they have limitations as analytical tools, and should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP. Table 2 provides a reconciliation of these Non-GAAP financial measures with their most closely related GAAP measures.

GAAP to Non-GAAP Reconciliation			Table 2	
(dollars in thousands)	March 31, 2015		December 31, 2014	
Total Shareholders’ Equity	$1,075,251		$1,055,086	
Less: Goodwill	31,517		31,517	
Tangible Common Equity	$1,043,734		$1,023,569	
Total Assets	$15,139,179		$14,787,208	
Less: Goodwill	31,517		31,517	
Tangible Assets	$15,107,662		$14,755,691	
Risk-Weighted Assets, determined in accordance with prescribed regulatory requirements [1]	$7,313,682		$7,077,035	
Total Shareholders’ Equity to Total Assets	7.10	%	7.14	%
Tangible Common Equity to Tangible Assets (Non-GAAP)	6.91	%	6.94	%
Tier 1 Capital Ratio [1]	14.62	%	14.69	%
Tangible Common Equity to Risk-Weighted Assets (Non-GAAP) [1]	14.27	%	14.46	%

[1] March 31, 2015 calculated under Basel III rules, which became effective January 1, 2015.

Table of Contents

Analysis of Statements of Income

Average balances, related income and expenses, and resulting yields and rates are presented in Table 3. An analysis of the change in net interest income, on a taxable-equivalent basis, is presented in Table 4.

Average Balances and Interest Rates - Taxable-Equivalent Basis — Table 3

	Three Months Ended March 31, 2015				Three Months Ended March 31, 2014			
(dollars in millions)	Average Balance	Income/ Expense	Yield/ Rate		Average Balance	Income/ Expense	Yield/ Rate	
Earning Assets								
Interest-Bearing Deposits in Other Banks	$3.1	$—	0.44	%	$5.7	$—	0.23	%
Funds Sold	484.3	0.2	0.21		270.5	0.1	0.20	
Investment Securities								
Available-for-Sale								
Taxable	1,560.8	6.5	1.67		1,548.9	7.2	1.86	
Non-Taxable	723.3	5.7	3.16		677.5	5.5	3.27	
Held-to-Maturity								
Taxable	4,140.9	22.8	2.21		4,501.6	26.3	2.34	
Non-Taxable	249.1	2.5	3.94		252.6	2.5	3.96	
Total Investment Securities	6,674.1	37.5	2.25		6,980.6	41.5	2.38	
Loans Held for Sale	3.1	—	3.63		4.2	0.1	4.68	
Loans and Leases [1]								
Commercial and Industrial	1,130.5	8.9	3.18		923.8	7.8	3.41	
Commercial Mortgage	1,449.5	13.7	3.83		1,250.0	12.7	4.12	
Construction	103.8	1.1	4.39		97.3	1.1	4.43	
Commercial Lease Financing	225.9	1.9	3.42		245.8	1.4	2.33	
Residential Mortgage	2,631.3	27.5	4.18		2,286.9	24.4	4.27	
Home Equity	878.5	8.1	3.72		781.8	7.6	3.97	
Automobile	331.5	4.3	5.25		263.3	3.5	5.39	
Other [2]	302.1	5.5	7.36		255.1	5.0	7.90	
Total Loans and Leases	7,053.1	71.0	4.06		6,104.0	63.5	4.19	
Other	66.0	0.3	1.83		76.8	0.3	1.57	
Total Earning Assets [3]	14,283.7	109.0	3.07		13,441.8	105.5	3.16	
Cash and Due From Banks	136.5				142.5			
Other Assets	525.8				449.6			
Total Assets	$14,946.0				$14,033.9			
Interest-Bearing Liabilities								
Interest-Bearing Deposits								
Demand	$2,577.1	$0.2	0.03	%	$2,325.8	$0.2	0.03	%
Savings	4,941.0	1.1	0.09		4,515.6	1.0	0.09	
Time	1,378.3	1.1	0.33		1,373.1	1.2	0.37	
Total Interest-Bearing Deposits	8,896.4	2.4	0.11		8,214.5	2.4	0.12	

Short-Term Borrowings	8.5	—	0.14		10.0	—	0.14	
Securities Sold Under Agreements to Repurchase	678.0	6.4	3.76		794.4	6.4	3.22	
Other Debt	173.9	0.6	1.43		174.7	0.6	1.44	
Total Interest-Bearing Liabilities	9,756.8	9.4	0.39		9,193.6	9.4	0.41	
Net Interest Income		$99.6				$96.1		
Interest Rate Spread			2.68	%			2.75	%
Net Interest Margin			2.81	%			2.87	%
Noninterest-Bearing Demand Deposits	3,890.0				3,600.0			
Other Liabilities	235.1				206.9			
Shareholders' Equity	1,064.1				1,033.4			
Total Liabilities and Shareholders' Equity	$14,946.0				$14,033.9			

[1] Non-performing loans and leases are included in the respective average loan and lease balances. Income, if any, on such loans and leases is recognized on a cash basis.

[2] Comprised of other consumer revolving credit, installment, and consumer lease financing.

[3] Interest income includes taxable-equivalent basis adjustments, based upon a federal statutory tax rate of 35%, of $2.9 million and $2.8 million for the three months ended March 31, 2015 and 2014, respectively.

Table of Contents

Analysis of Change in Net Interest Income - Taxable-Equivalent Basis — Table 4

(dollars in millions)	Three Months Ended March 31, 2015 Compared to March 31, 2014		
	Volume [1]	Rate [1]	Total
Change in Interest Income:			
Funds Sold	$0.1	$—	$0.1
Investment Securities			
Available-for-Sale			
Taxable	0.1	(0.8)	(0.7)
Non-Taxable	0.4	(0.2)	0.2
Held-to-Maturity			
Taxable	(2.1)	(1.4)	(3.5)
Total Investment Securities	(1.6)	(2.4)	(4.0)
Loans Held for Sale	(0.1)	—	(0.1)
Loans and Leases			
Commercial and Industrial	1.6	(0.5)	1.1
Commercial Mortgage	1.9	(0.9)	1.0
Construction	0.1	(0.1)	—
Commercial Lease Financing	(0.1)	0.6	0.5
Residential Mortgage	3.6	(0.5)	3.1
Home Equity	0.9	(0.4)	0.5
Automobile	0.9	(0.1)	0.8
Other [2]	0.9	(0.4)	0.5
Total Loans and Leases	9.8	(2.3)	7.5
Total Change in Interest Income	8.2	(4.7)	3.5
Change in Interest Expense:			
Interest-Bearing Deposits			
Savings	0.1	—	0.1
Time	—	(0.1)	(0.1)
Total Interest-Bearing Deposits	0.1	(0.1)	—
Securities Sold Under Agreements to Repurchase	(1.0)	1.0	—
Total Change in Interest Expense	(0.9)	0.9	—
Change in Net Interest Income	$9.1	$(5.6)	$3.5

[1] The change in interest income and expense not solely due to changes in volume or rate has been allocated on a pro-rata basis to the volume and rate columns.

[2] Comprised of other consumer revolving credit, installment, and consumer lease financing.

Net Interest Income

Net interest income is affected by the size and mix of our balance sheet components as well as the spread between interest earned on assets and interest paid on liabilities. Net interest margin is defined as net interest income, on a taxable-equivalent basis, as a percentage of average earning assets.

Net interest income was $96.8 million in the first quarter of 2015, an increase of $3.5 million or 4% compared to the same period in 2014. On a taxable-equivalent basis, net interest income was $99.6 million in the first quarter of 2015, an increase of $3.5 million or 4% compared to the same period in 2014. Net interest margin was 2.81% for the first quarter of 2015, a decrease of six basis points compared to the same period in 2014. The lower margin in 2015 was primarily due to lower yields in our investment securities and loans, reflective of the current low interest rate

environment.

Yields on our earning assets decreased by nine basis points in the first quarter of 2015 compared to the same period in 2014 primarily due to lower yields in our investment securities and loan portfolio. Yields on our investment securities portfolio decreased by 13 basis points in the first quarter of 2015 compared to the same period in 2014 partly due to slightly higher premium amortization and reinvestment into lower yielding securities due to the current low interest rate environment. Yields on our loans and leases decreased by 13 basis points, with lower yields in nearly every loan category, in the first quarter of 2015 compared to the same period in 2014 as a result of the current low interest rate environment. Yields on our commercial

Table of Contents

and industrial portfolio declined by 23 basis points and yields on our commercial mortgage portfolio decreased by 29 basis points in the first quarter of 2015 compared to the same period in 2014. Yields on our residential mortgage portfolio decreased by nine basis points in the first quarter of 2015 compared to the same period in 2014 primarily due to continued payoff activity of higher-rate mortgage loans and the addition to our portfolio of lower-rate mortgage loans. Partially offsetting the lower yields on our earning assets in the first quarter of 2015 compared to the same period in 2014 were slightly lower funding costs due to marginally lower rates paid on our time deposits. Rates on our securities sold under agreements to repurchase increased by 54 basis points in the first quarter of 2015 compared to the same period in 2014 primarily due to a decrease in funds from local government entities leaving the balance in our repurchase agreements consisting mainly of those with private entities which have longer terms at relatively higher interest rates.

Average balances of our earning assets increased by $841.9 million or 6% in the first quarter of 2015 compared to the same period in 2014 primarily due to an increase in the average balances of our funds sold and loans and leases. Average balance of our funds sold increased by $213.9 million in the first quarter of 2015 compared to the same period in 2014 primarily due to excess liquidity. Average balances of our loans and leases portfolio increased by $949.0 million in the first quarter of 2015 compared to the same period in 2014 primarily due to higher average balances in our commercial and industrial, commercial mortgage, and residential mortgage portfolios. The average balance of our commercial and industrial loan portfolio increased by $206.6 million due to an increase in corporate demand for funding. The average balance of our commercial mortgage portfolio increased by $199.5 million in the first quarter of 2015 compared to the same period in 2014 primarily due to increased demand from new and existing customers as the real estate market in Hawaii continued to improve. The average balance of our residential mortgage portfolio increased by $344.4 million in the first quarter of 2015 compared to the same period in 2014 primarily due to our decision to add more conforming saleable loans to our portfolio. Partially offsetting the increase in the average balances of our loans and leases portfolio was a $306.5 million decrease in the average balance of our total investment securities portfolio primarily due to the shift in the mix of our earning assets from investment securities to loans.

Average balances of our interest-bearing liabilities increased by $563.2 million or 6% in the first quarter of 2015 compared to the same period in 2014 primarily due to our efforts to grow our relationship checking and savings deposit products, which was partially offset by a $116.3 million decrease in the average balance of our securities sold under agreements to repurchase with local government entities.

Provision for Credit Losses

The provision for credit losses (the "Provision") reflects our judgment of the expense or benefit necessary to achieve the appropriate amount of the Allowance. We maintain the Allowance at levels adequate to cover our estimate of probable credit losses as of the end of the reporting period. The Allowance is determined through detailed quarterly analyses of the loan and lease portfolio. The Allowance is based on our loss experience and changes in the economic environment, as well as an ongoing assessment of credit quality. Additional factors that are considered in determining the amount of the Allowance are the level of net charge-offs, non-performing assets, risk rating migration, as well as changes in our portfolio size and composition. We recorded no Provision in the first quarter of 2015 or 2014. Our decision to not record a Provision was reflective of our evaluation as to the adequacy of the Allowance. For further discussion on the Allowance, see the “Corporate Risk Profile - Reserve for Credit Losses” section in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A").

Table of Contents

Noninterest Income

Noninterest income increased by $7.5 million or 17% in the first quarter of 2015 compared to the same period in 2014.

Table 5 presents the components of noninterest income.

Noninterest Income — Table 5

(dollars in thousands)	Three Months Ended March 31, 2015	2014	Change
Trust and Asset Management	$12,180	$11,852	$328
Mortgage Banking	1,693	2,005	(312)
Service Charges on Deposit Accounts	8,537	8,878	(341)
Fees, Exchange, and Other Service Charges	12,897	12,939	(42)
Investment Securities Gains, Net	10,231	2,160	8,071
Annuity and Insurance	2,044	2,123	(79)
Bank-Owned Life Insurance	1,734	1,602	132
Other Income	2,991	3,209	(218)
Total Noninterest Income	$52,307	$44,768	$7,539

Trust and asset management income is comprised of fees earned from the management and administration of trusts and other customer assets. These fees are largely based upon the market value of the assets we manage and the fee rate charged to customers. Total trust assets under administration were $10.3 billion and $10.2 billion as of March 31, 2015 and 2014, respectively. Trust and asset management income increased by $0.3 million or 3% in the first quarter of 2015 compared to the same period in 2014 primarily due to market value increases and higher trust termination fees.

Mortgage banking income is highly influenced by mortgage interest rates, the housing market, and the amount of conforming saleable loans we keep in our portfolio. Mortgage banking income decreased by $0.3 million or 16% in the first quarter of 2015 compared to the same period in 2014. This decrease was primarily due to our decision to add more conforming saleable loans to our portfolio which caused a reduction to our servicing income and our gains on sales of residential mortgage loans.

Service charges on deposit accounts decreased by $0.3 million or 4% in the first quarter of 2015 compared to the same period in 2014. This decrease was primarily due to a $0.2 million decrease in account analysis fees combined with a $0.2 million decrease in overdraft fees.

Fees, exchange, and other service charges are primarily comprised of debit and credit card income, fees from ATMs, merchant service activity, and other loan fees and service charges. Fees, exchange, and other service charges remained relatively unchanged in the first quarter of 2015 compared to the same period in 2014. Decreases in other loan fees ($0.5 million), merchant income ($0.3 million), and ATM fees ($0.2 million) were largely offset by a $0.8 million increase in commissions and fees related to our credit card business.

Net gains on sales of investment securities totaled $10.2 million in the first quarter of 2015 compared to $2.2 million during the same period in 2014. The net gain in the first quarter of 2015 was primarily due to a $10.1 million gain on the sale of 95,000 Visa Class B shares. The net gain in the first quarter of 2014 was primarily due to a $2.0 million gain on the sale of 22,000 Visa Class B shares. We received these Class B shares in 2008 as part of Visa's initial public offering. These shares are transferable only under limited circumstances until they can be converted into the publicly traded Class A shares. This conversion will not occur until the settlement of certain litigation which is indemnified by Visa members such as the Company. Visa funded an escrow account from its initial public offering to

settle these litigation claims. Should this escrow account not be sufficient to cover these litigation claims, Visa is entitled to fund additional amounts to the escrow account by reducing each member bank's Class B conversion ratio to unrestricted Class A shares. Concurrent with the sale of these Visa Class B shares, we entered into an agreement with the buyer that requires payment to the buyer in the event Visa further reduces the conversion ratio. Based on the existing transfer restriction and the uncertainty of the covered litigation, the remaining 297,814 Visa Class B shares (490,887 Class A equivalent shares) that we own are carried at a zero cost basis. We also contributed to the Bank of Hawaii Foundation 4,700 and 5,500 Visa Class B shares during the first quarters of 2015 and 2014, respectively.

Bank-owned life insurance increased by $0.1 million or 8% in the first quarter of 2015 compared to the same periods in 2014. This increase was primarily due to new policies purchased during the second quarter of 2014.

Other noninterest income decreased by $0.2 million or 7% in the first quarter of 2015 compared to the same period in 2014 primarily due to a slight decrease in income from foreign exchange contracts.

Table of Contents

Noninterest Expense

Noninterest expense increased by $3.4 million or 4% in the first quarter of 2015 compared to the same period in 2014.

Table 6 presents the components of noninterest expense.

Noninterest Expense Table 6

	Three Months Ended March 31,		
(dollars in thousands)	2015	2014	Change
Salaries	$27,914	$27,914	$—
Incentive Compensation	4,514	4,231	283
Share-Based Compensation	2,345	1,969	376
Commission Expense	1,592	1,059	533
Retirement and Other Benefits	4,731	4,986	(255)
Payroll Taxes	3,585	3,568	17
Medical, Dental, and Life Insurance	3,184	2,621	563
Separation Expense	1,915	549	1,366
Total Salaries and Benefits	49,780	46,897	2,883
Net Occupancy	9,333	9,417	(84)
Net Equipment	5,288	4,603	685
Data Processing	3,773	3,649	124
Professional Fees	2,334	2,260	74
FDIC Insurance	2,140	2,076	64
Other Expense:			
Delivery and Postage Services	2,284	2,368	(84)
Mileage Program Travel	1,323	1,399	(76)
Merchant Transaction and Card Processing Fees	1,144	1,109	35
Advertising	1,084	1,310	(226)
Other	8,432	8,459	(27)
Total Other Expense	14,267	14,645	(378)
Total Noninterest Expense	$86,915	$83,547	$3,368

Salaries and benefits expense increased by $2.9 million or 6% in the first quarter of 2015 compared to the same period in 2014 primarily due to a $1.4 million increase in separation expense. Medical, dental, and life insurance expense increased by $0.6 million primarily due to higher medical claims in our self-insured plan. Commission expense increased by $0.5 million primarily due to an increase in both loan origination and refinance activity.

Net equipment expense increased by $0.7 million or 15% in the first quarter of 2015 compared to the same period in 2014. This increase was primarily due to a $0.5 million increase in software license fees and maintenance.

Other noninterest expense decreased by $0.4 million or 3% in the first quarter of 2015 compared to the same period in 2014. This decrease was primarily due to a $0.5 million decrease in operational losses, which include losses as a result of bank error, fraud, items processing, or theft. In addition, advertising expense decreased by $0.2 million. These decreases were partially offset by a $0.2 million increase in amortization expense related to our solar energy partnership investments.

Provision for Income Taxes

Table 7 presents our provision for income taxes and effective tax rates.

Provision for Income Taxes and Effective Tax Rates Table 7

	Three Months Ended March 31,	
(dollars in thousands)	2015	2014
Provision for Income Taxes	$19,720	$15,862
Effective Tax Rates	31.72 %	29.13 %

The provision for income taxes in the first quarter of 2015 was $3.9 million or 24% higher compared to the same period in 2014. The higher effective tax rate in the first quarter of 2015 was primarily due to a $1.2 million credit in the first quarter of

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

2014 for the release of reserves due to a settlement with the State of Hawaii related to prior year tax issues. The effective tax rate in the first quarter of 2015 also increased due to higher pre-tax income compared to a fixed amount of tax credits.

Analysis of Statements of Condition

Investment Securities

The carrying value of our investment securities portfolio was $6.6 billion as of March 31, 2015, a decrease of $178.3 million or 3% compared to December 31, 2014. As of March 31, 2015, our investment securities portfolio was comprised of securities with an average base duration of approximately 3.2 years.

We continually evaluate our investment securities portfolio in response to established asset/liability management objectives, changing market conditions that could affect profitability, and the level of interest rate risk to which we are exposed. These evaluations may cause us to change the level of funds we deploy into investment securities, change the composition of our investment securities portfolio, and change the proportion of investments made into the available-for-sale and held-to-maturity investment categories.

During the first three months of 2015, we continued to reduce our positions in mortgage-backed securities issued by Ginnie Mae. We re-invested these proceeds primarily into higher yielding loan products. In addition, we increased our holdings in Small Business Administration securities and U.S. Treasury notes. Ginnie Mae mortgage-backed securities continue to be our largest concentration in our portfolio. As of March 31, 2015, our portfolio of Ginnie Mae mortgage-backed securities was primarily comprised of securities issued in 2008 or later. As of March 31, 2015, the credit ratings of these mortgage-backed securities were all AAA-rated, with a low probability of a change in ratings in the near future. As of March 31, 2015, our available-for-sale investment securities portfolio was comprised of securities with an average base duration of approximately 2.7 years.

Gross unrealized gains in our investment securities portfolio were $129.0 million as of March 31, 2015 and $108.5 million as of December 31, 2014. Gross unrealized losses on our temporarily impaired investment securities were $22.3 million as of March 31, 2015 and $44.3 million as of December 31, 2014. This decrease in our gross unrealized loss positions on our temporarily impaired investment securities was primarily due to market interest rates declining during the first quarter of 2015. The gross unrealized loss positions were primarily related to mortgage-backed securities issued by Ginnie Mae and corporate bonds. See Note 2 to the Consolidated Financial Statements for more information.

As of March 31, 2015, included in our investment securities portfolio were debt securities issued by political subdivisions within the State of Hawaii of $604.3 million, representing 59% of the total fair value of the Company's municipal debt securities. Of the entire Hawaii municipal bond portfolio, 91% were credit-rated Aa2 or better by Moody's while most of the remaining Hawaii municipal bonds were credit-rated A2 or better by at least one nationally recognized statistical rating organization. Approximately 77% of our Hawaii municipal bond holdings were general obligation issuances. As of March 31, 2015, there were no other holdings of municipal debt securities that were issued by a single state or political subdivision which comprised more than 10% of the total fair value of our municipal debt securities.

Table of Contents

Loans and Leases

Table 8 presents the composition of our loan and lease portfolio by major categories.

Loan and Lease Portfolio Balances Table 8

(dollars in thousands)	March 31, 2015	December 31, 2014
Commercial		
Commercial and Industrial	$1,141,408	$1,055,243
Commercial Mortgage	1,477,902	1,437,513
Construction	111,381	109,183
Lease Financing	224,419	226,189
Total Commercial	2,955,110	2,828,128
Consumer		
Residential Mortgage	2,699,434	2,571,090
Home Equity	884,742	866,688
Automobile	339,686	323,848
Other [1]	299,656	307,835
Total Consumer	4,223,518	4,069,461
Total Loans and Leases	$7,178,628	$6,897,589

[1] Comprised of other revolving credit, installment, and lease financing.

Total loans and leases as of March 31, 2015 increased by $281.0 million or 4% from December 31, 2014 due to growth in both our commercial and consumer lending portfolios.

Commercial loans and leases as of March 31, 2015 increased by $127.0 million or 4% from December 31, 2014. Commercial and industrial loans increased by $86.2 million or 8% from December 31, 2014 due to an increase in corporate demand for funding. Commercial mortgage loans increased by $40.4 million or 3% from December 31, 2014 primarily due to increased demand from new and existing customers as the real estate economy in Hawaii continued to improve. Construction loans increased by $2.2 million or 2% from December 31, 2014 primarily due to increased activity in construction projects such as condominiums and low-income housing. Lease financing decreased by $1.8 million or 1% from December 31, 2014 primarily due to paydowns on a leveraged lease.

Consumer loans and leases as of March 31, 2015 increased by $154.1 million or 4% from December 31, 2014. Residential mortgage loans increased by $128.3 million or 5% from December 31, 2014 primarily due to our decision to retain additional conforming saleable loans in our portfolio. Home equity loans increased by $18.1 million or 2% from December 31, 2014 primarily due to a successful campaign to increase new loan production. Automobile loans increased by $15.8 million or 5% from December 31, 2014 due to increased customer demand combined with market share gains. Other consumer loans decreased by $8.2 million or 3% from December 31, 2014 due primarily to payoffs of two large other revolving credits.

Table of Contents

Table 9 presents the composition of our loan and lease portfolio by geographic area and by major categories.

Geographic Distribution of Loan and Lease Portfolio — Table 9

(dollars in thousands)	Hawaii	U.S. Mainland [1]	Guam	Other Pacific Islands	Foreign [2]	Total
March 31, 2015						
Commercial						
Commercial and Industrial	$1,020,761	$69,418	$50,153	$ 807	$269	$1,141,408
Commercial Mortgage	1,349,973	30,078	97,851	—	—	1,477,902
Construction	111,381	—	—	—	—	111,381
Lease Financing	43,340	175,185	608	—	5,286	224,419
Total Commercial	2,525,455	274,681	148,612	807	5,555	2,955,110
Consumer						
Residential Mortgage	2,590,173	—	106,308	2,953	—	2,699,434
Home Equity	849,160	3,435	30,491	1,656	—	884,742
Automobile	261,352	182	72,782	5,370	—	339,686
Other [3]	223,399	—	36,064	40,187	6	299,656
Total Consumer	3,924,084	3,617	245,645	50,166	6	4,223,518
Total Loans and Leases	$6,449,539	$278,298	$394,257	$ 50,973	$5,561	$7,178,628
December 31, 2014						
Commercial						
Commercial and Industrial	$935,258	$67,367	$50,699	$ 897	$1,022	$1,055,243
Commercial Mortgage	1,318,413	27,060	92,040	—	—	1,437,513
Construction	109,183	—	—	—	—	109,183
Lease Financing	44,238	176,618	647	—	4,686	226,189
Total Commercial	2,407,092	271,045	143,386	897	5,708	2,828,128
Consumer						
Residential Mortgage	2,460,353	—	107,714	3,023	—	2,571,090
Home Equity	831,722	3,909	29,377	1,680	—	866,688
Automobile	248,598	285	69,985	4,980	—	323,848
Other [3]	233,396	—	34,885	39,547	7	307,835
Total Consumer	3,774,069	4,194	241,961	49,230	7	4,069,461
Total Loans and Leases	$6,181,161	$275,239	$385,347	$ 50,127	$5,715	$6,897,589

[1] For secured loans and leases, classification as U.S. Mainland is made based on where the collateral is located. For unsecured loans and leases, classification as U.S. Mainland is made based on the location where the majority of the borrower's business operations are conducted.

[2] Loans and leases classified as Foreign represent those which are recorded in the Company's international business units.

[3] Comprised of other revolving credit, installment, and lease financing.

Our commercial and consumer lending activities are concentrated primarily in Hawaii and the Pacific Islands. Our commercial loan and lease portfolio to borrowers based on the U.S. Mainland includes leveraged lease financing and participation in Shared National Credits. Our consumer loan and lease portfolio includes limited lending activities on the U.S. Mainland.

Our Hawaii loan and lease portfolio increased by $268.4 million or 4% from December 31, 2014, reflective of a healthy Hawaii economy.

53

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

Other Assets

Table 10 presents the major components of other assets.

Other Assets		Table 10
(dollars in thousands)	March 31, 2015	December 31, 2014
Federal Home Loan Bank and Federal Reserve Bank Stock	$63,882	$66,374
Derivative Financial Instruments	16,473	16,515
Low-Income Housing and Other Equity Investments	75,099	77,495
Deferred Compensation Plan Assets	19,577	18,794
Prepaid Expenses	10,390	7,787
Accounts Receivable	23,618	13,405
Other	26,253	25,518
Total Other Assets	$235,292	$225,888

Other assets increased by $9.4 million or 4% from December 31, 2014. This increase was primarily due to a $10.2 million increase in accounts receivable balances due mainly to proceeds related to the sale of Visa Class B shares received in the second quarter of 2015. Also contributing to the increase was a $2.3 million increase in prepaid insurance and a $1.1 million increase in executive deferred compensation plan. This was partially offset by a $2.6 million redemption of a portion of our FHLB stock and a $2.4 million decrease mainly related to the amortization of low-income housing and solar energy partnership investments.

Deposits

Table 11 presents the composition of our deposits by major customer categories.

Deposits		Table 11
(dollars in thousands)	March 31, 2015	December 31, 2014
Consumer	$6,220,391	$6,092,929
Commercial	5,444,814	5,163,352
Public and Other	1,314,411	1,376,808
Total Deposits	$12,979,616	$12,633,089

Total deposits were $13.0 billion as of March 31, 2015, an increase of $346.5 million or 3% from December 31, 2014. This increase was primarily due to a $281.5 million increase in commercial deposits, mainly reflecting core deposit growth. In addition, consumer deposits increased by $127.5 million, mainly reflecting core deposit growth primarily resulting from our efforts to grow our relationship checking and savings deposit products. These increases were partially offset by a $102.2 million decrease in public time deposits mainly due to maturing time deposits held by local government entities.

Table 12 presents the composition of our savings deposits.

Savings Deposits		Table 12
(dollars in thousands)	March 31, 2015	December 31, 2014
Money Market	$1,895,925	$1,766,173
Regular Savings	3,118,761	3,040,402
Total Savings Deposits	$5,014,686	$4,806,575

54

Table of Contents

Securities Sold Under Agreements to Repurchase

Table 13 presents the composition of our securities sold under agreements to repurchase.

Securities Sold Under Agreements to Repurchase — Table 13

(dollars in thousands)	March 31, 2015	December 31, 2014
Government Entities	$72,329	$88,601
Private Institutions	600,000	600,000
Total Securities Sold Under Agreements to Repurchase	$672,329	$688,601

Securities sold under agreements to repurchase as of March 31, 2015 decreased by $16.3 million or 2% from December 31, 2014. As of March 31, 2015, the weighted-average maturity was 268 days for our repurchase agreements with government entities and 4.2 years for our repurchase agreements with private institutions. Some of our repurchase agreements with private institutions may be terminated at earlier specified dates by the private institution or in some cases by either the private institution or the Company. If all such agreements were to terminate at the earliest possible date, the weighted average maturity for our repurchase agreements with private institutions would decrease to 1.6 years. As of March 31, 2015, the weighted-average interest rate for outstanding agreements with government entities and private institutions was 0.31% and 4.21%, respectively, with all rates being fixed. Each of our repurchase agreements is accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities.

Other Debt

Table 14 presents the composition of our other debt.

Other Debt — Table 14

(dollars in thousands)	March 31, 2015	December 31, 2014
Federal Home Loan Bank Advances	$150,000	$150,000
Non-Recourse Debt	13,005	13,005
Capital Lease Obligations	10,893	10,907
Total	$173,898	$173,912

Other debt was $173.9 million as of March 31, 2015, relatively unchanged from December 31, 2014. This balance was mainly comprised of $150.0 million in FHLB advances with a stated interest rate of 0.60% and maturity dates in 2015 and 2016. These advances were primarily for asset/liability management purposes. As of March 31, 2015, our remaining unused line of credit with the FHLB was $747.5 million.

Table of Contents

Analysis of Business Segments

Our business segments are defined as Retail Banking, Commercial Banking, Investment Services, and Treasury and Other.

Table 15 summarizes net income from our business segments. Additional information about segment performance is presented in Note 9 to the Consolidated Financial Statements.

Business Segment Net Income Table 15

	Three Months Ended March 31,	
(dollars in thousands)	2015	2014
Retail Banking	$9,885	$6,218
Commercial Banking	15,400	11,261
Investment Services	2,053	1,738
Total	27,338	19,217
Treasury and Other	15,104	19,375
Consolidated Total	$42,442	$38,592

Retail Banking

Net income increased by $3.7 million or 59% in the first quarter of 2015 compared to the same period in 2014 primarily due to an increase in net interest income, partially offset by an increase in noninterest expense. The increase in net interest income was primarily due to higher volume in both the lending and deposit portfolios and partially due to higher earnings credits on the segment’s deposit portfolio. The increase in noninterest expense was primarily due to higher allocated expenses.

Commercial Banking

Net income increased by $4.1 million or 37% in the first quarter of 2015 compared to the same period in 2014 primarily due to an increase in net interest income and a decrease in the Provision. This was partially offset by a decrease in noninterest income and an increase in noninterest expense. The increase in net interest income was primarily due to higher volume in both the lending and deposit portfolios, and partially due to higher earnings credits on the segment’s deposit portfolio. The decrease in the Provision was due to higher net recoveries on loans and leases in the current period. The decrease in noninterest income was primarily due to lower nonrecurring loan fees. The increase in noninterest expense was primarily due to higher allocated expenses.

Investment Services

Net income increased by $0.3 million or 18% in the first quarter of 2015 compared to the same period in 2014 primarily due to increases in net interest income and noninterest income, partially offset by an increase in noninterest expense. The increase in net interest income was due to both higher volume and higher earnings credits on the segment’s deposit portfolio. The increase in noninterest income was primarily due to higher trust and asset management income primarily due to market value increases and higher trust termination fees. The increase in noninterest expense was primarily due to higher allocated expenses.

Treasury and Other

Net income decreased by $4.3 million or 22% in the first quarter of 2015 compared to the same period in 2014 primarily due to a decrease in net interest income and an increase in noninterest expense, partially offset by an

increase in noninterest income. The decrease in net interest income was primarily due to higher deposit funding costs and lower interest income from the investment securities portfolio resulting from a reduction in volume and lower associated yields. The increase in noninterest expense was due to higher separation expense. The increase in noninterest income was due to a $10.1 million net gain on sale of 95,000 Visa Class B shares.

Other organizational units (Technology, Operations, Marketing, Human Resources, Finance, Credit and Risk Management, and Corporate and Regulatory Administration) included in Treasury and Other provide a wide-range of support to the Company's other income earning segments. Expenses incurred by these support units are charged to the business segments through an internal cost allocation process.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Corporate Risk Profile

Credit Risk

As of March 31, 2015, our overall credit risk profile reflects a healthy Hawaii economy, with decreasing levels of non-performing assets and lower credit losses. The underlying risk profile of our lending portfolio continued to remain strong in the first quarter of 2015.

We actively manage exposures with deteriorating asset quality to reduce levels of potential loss exposure and closely monitor our reserves and capital to address both anticipated and unforeseen issues. Risk management activities include detailed analysis of portfolio segments and stress tests of certain segments to ensure that reserve and capital levels are appropriate. We perform frequent loan and lease-level risk monitoring and risk rating reviews, which provide opportunities for early interventions to allow for credit exits or restructuring, loan and lease sales, and voluntary workouts and liquidations.

Table of Contents

Non-Performing Assets and Accruing Loans and Leases Past Due 90 Days or More

Table 16 presents information on non-performing assets ("NPAs") and accruing loans and leases past due 90 days or more.

Non-Performing Assets and Accruing Loans and Leases Past Due 90 Days or More — Table 16

(dollars in thousands)	March 31, 2015		December 31, 2014	
Non-Performing Assets				
Non-Accrual Loans and Leases				
Commercial				
Commercial and Industrial	$8,641		$9,088	
Commercial Mortgage	732		745	
Total Commercial	9,373		9,833	
Consumer				
Residential Mortgage	14,344		14,841	
Home Equity	2,965		3,097	
Total Consumer	17,309		17,938	
Total Non-Accrual Loans and Leases	26,682		27,771	
Foreclosed Real Estate	2,095		2,311	
Total Non-Performing Assets	$28,777		$30,082	
Accruing Loans and Leases Past Due 90 Days or More				
Commercial				
Commercial and Industrial	$—		$2	
Total Commercial	—		2	
Consumer				
Residential Mortgage	3,914		4,506	
Home Equity	2,425		2,596	
Automobile	537		616	
Other [1]	1,078		941	
Total Consumer	7,954		8,659	
Total Accruing Loans and Leases Past Due 90 Days or More	$7,954		$8,661	
Restructured Loans on Accrual Status and Not Past Due 90 Days or More	$46,639		$45,474	
Total Loans and Leases	$7,178,628		$6,897,589	
Ratio of Non-Accrual Loans and Leases to Total Loans and Leases	0.37	%	0.40	%
Ratio of Non-Performing Assets to Total Loans and Leases and Foreclosed Real Estate	0.40	%	0.44	%
Ratio of Commercial Non-Performing Assets to Total Commercial Loans and Leases and Commercial Foreclosed Real Estate	0.34	%	0.38	%
Ratio of Consumer Non-Performing Assets to Total Consumer Loans and Leases and Consumer Foreclosed Real Estate	0.44	%	0.47	%
Ratio of Non-Performing Assets and Accruing Loans and Leases Past Due 90 Days or More to Total Loans and Leases and Foreclosed Real Estate	0.51	%	0.56	%
Changes in Non-Performing Assets				
Balance as of December 31, 2014	$30,082			
Additions	621			
Reductions				
Payments	(1,427	)		

Return to Accrual Status	(187)
Sales of Foreclosed Real Estate	(37)
Charge-offs/Write-downs	(275)
Total Reductions	(1,926)
Balance as of March 31, 2015	$28,777

[1] Comprised of other revolving credit, installment, and lease financing.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

NPAs consist of non-accrual loans and leases, and foreclosed real estate. Changes in the level of non-accrual loans and leases typically represent increases for loans and leases that reach a specified past due status, offset by reductions for loans and leases that are charged-off, paid down, sold, transferred to foreclosed real estate, or are no longer classified as non-accrual because they have returned to accrual status.

Total NPAs were $28.8 million as of March 31, 2015, a decrease of $1.3 million or 4% from December 31, 2014. The ratio of our NPAs to total loans and leases and foreclosed real estate was 0.40% as of March 31, 2015 and 0.44% as of December 31, 2014. The decrease was primarily due to a $0.5 million decrease in residential mortgage non-accrual loans and a $0.5 million reduction in commercial non-accrual loans due to payments.

Commercial and industrial non-accrual loans decreased by $0.4 million or 5% from December 31, 2014 due to paydowns. As of March 31, 2015, four commercial borrowers comprised 94% of the non-accrual balance in this category. We have individually evaluated these four loans for impairment and have recorded partial charge-offs totaling $11.9 million on three of these loans.

Commercial mortgage non-accrual loans were relatively unchanged from December 31, 2014. We have individually evaluated the two remaining commercial mortgage non-accrual loans for impairment and have recorded no charge-offs.

The largest component of our NPAs continues to be residential mortgage loans. Residential mortgage non-accrual loans decreased by $0.5 million or 3% from December 31, 2014 primarily due to $0.7 million in paydowns, partially offset by $0.2 million in additions. Residential mortgage non-accrual loans remain at elevated levels due mainly to the lengthy judiciary foreclosure process. As of March 31, 2015, our residential mortgage non-accrual loans were comprised of 39 loans with a weighted average current LTV ratio of 66%.

Foreclosed real estate represents property acquired as the result of borrower defaults on loans. Foreclosed real estate is recorded at fair value, less estimated selling costs, at the time of foreclosure. On an ongoing basis, properties are appraised as required by market conditions and applicable regulations. Foreclosed real estate decreased by $0.2 million or 9% from December 31, 2014.

Loans and Leases Past Due 90 Days or More and Still Accruing Interest

Loans and leases in this category are 90 days or more past due, as to principal or interest, and are still accruing interest because they are well secured and in the process of collection. Loans and leases past due 90 days or more and still accruing interest were $8.0 million as of March 31, 2015, a $0.7 million or 8% decrease from December 31, 2014. This decrease was primarily in our residential mortgage portfolio.

Impaired Loans

Impaired loans are defined as loans for which we believe it is probable we will not collect all amounts due according to the contractual terms of the loan agreement. Included in impaired loans are all classes of commercial non-accruing loans (except lease financing and small business loans), all loans modified in a TDR (including accruing TDRs), and other loans where we believe that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans exclude lease financing and smaller balance homogeneous loans (consumer and small business non-accruing loans) that are collectively evaluated for impairment. Impaired loans were $65.5 million as of March 31, 2015 and $64.7 million as of December 31, 2014, and had a related Allowance of $5.7 million as of March 31, 2015 and $5.9 million as of December 31, 2014. As of March 31, 2015, we have recorded charge-offs of $18.0 million related to our total impaired loans. Our impaired loans are considered in management's assessment of the overall adequacy of the Allowance.

59

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

Table 17 presents information on loans with terms that have been modified in a TDR.

Loans Modified in a Troubled Debt Restructuring		Table 17
(dollars in thousands)	March 31, 2015	December 31, 2014
Commercial		
Commercial and Industrial	$14,545	$13,176
Commercial Mortgage	6,183	5,734
Construction	1,667	1,689
Total Commercial	22,395	20,599
Consumer		
Residential Mortgage	31,725	32,331
Home Equity	1,203	1,012
Automobile	5,546	5,375
Other [1]	979	913
Total Consumer	39,453	39,631
Total	$61,848	$60,230

[1] Comprised of other revolving credit, installment, and lease financing.

Loans modified in a TDR increased by $1.6 million or 3% from December 31, 2014. Residential mortgage loans remain our largest TDR loan class.

60

Table of Contents

Reserve for Credit Losses

Table 18 presents the activity in our reserve for credit losses.

Reserve for Credit Losses Table 18

	Three Months Ended		
	March 31,	December 31,	March 31,
(dollars in thousands)	2015	2014	2014
Balance at Beginning of Period	$114,575	$116,249	$121,521
Loans and Leases Charged-Off			
Commercial			
Commercial and Industrial	(235)	(205)	(819)
Consumer			
Residential Mortgage	(559)	(97)	(329)
Home Equity	(216)	(293)	(351)
Automobile	(1,428)	(1,376)	(917)
Other [1]	(1,650)	(1,772)	(1,622)
Total Loans and Leases Charged-Off	(4,088)	(3,743)	(4,038)
Recoveries on Loans and Leases Previously Charged-Off			
Commercial			
Commercial and Industrial	646	396	920
Commercial Mortgage	14	14	14
Construction	8	8	5
Lease Financing	68	4	2
Consumer			
Residential Mortgage	342	542	272
Home Equity	881	204	551
Automobile	494	467	445
Other [1]	408	434	501
Total Recoveries on Loans and Leases Previously Charged-Off	2,861	2,069	2,710
Net Loans and Leases Charged-Off	(1,227)	(1,674)	(1,328)
Provision for Credit Losses	—	—	—
Provision for Unfunded Commitments	—	—	(57)
Balance at End of Period [2]	$113,348	$114,575	$120,136
Components			
Allowance for Loan and Lease Losses	$107,461	$108,688	$114,126
Reserve for Unfunded Commitments	5,887	5,887	6,010
Total Reserve for Credit Losses	$113,348	$114,575	$120,136
Average Loans and Leases Outstanding	$7,053,061	$6,746,332	$6,104,041
Ratio of Net Loans and Leases Charged-Off to Average Loans and Leases Outstanding (annualized)	0.07 %	0.10 %	0.09 %
Ratio of Allowance for Loan and Lease Losses to Loans and Leases Outstanding	1.50 %	1.58 %	1.84 %

[1] Comprised of other revolving credit, installment, and lease financing.

[2]

Included in this analysis is activity related to the Company's reserve for unfunded commitments, which is separately recorded in other liabilities in the consolidated statements of condition.

We maintain a reserve for credit losses that consists of two components, the Allowance and a reserve for unfunded commitments (the "Unfunded Reserve"). The reserve for credit losses provides for the risk of credit losses inherent in the loan and lease portfolio and is based on loss estimates derived from a comprehensive quarterly evaluation. The evaluation reflects analyses of individual borrowers and historical loss experience, supplemented as necessary by credit judgment that considers observable trends, conditions, and other relevant environmental and economic factors. The level of the Allowance is adjusted by recording an expense or recovery through the Provision. The level of the Unfunded Reserve is adjusted by recording an expense or recovery in other noninterest expense.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

Allowance for Loan and Lease Losses

As of March 31, 2015, the Allowance was $107.5 million or 1.50% of total loans and leases outstanding, compared with an Allowance of $108.7 million or 1.58% of total loans and leases outstanding as of December 31, 2014. The decrease in the Allowance was commensurate with the Company's strong credit risk profile and a healthy Hawaii economy.

Net charge-offs on loans and leases were $1.2 million or 0.07% of total average loans and leases, on an annualized basis, in the first quarter of 2015 compared to net charge-offs of $1.3 million or 0.09% of total average loans and leases, on an annualized basis, in the first quarter of 2014. All of our commercial portfolios were in net recovery positions in the first quarter of 2015. Net recoveries in our commercial portfolios were $0.5 million for the first three months of 2015 compared to $0.1 million for the same period in 2014. The favorable variance was primarily due to a recovery related to one commercial and industrial loan. Net charge-offs in our consumer portfolios were $1.7 million for the first three months of 2015 compared to $1.5 million for the same period in 2014.

Although we determine the amount of each component of the Allowance separately, the Allowance as a whole was considered appropriate by management as of March 31, 2015, based on our ongoing analysis of estimated probable credit losses, credit risk profiles, economic conditions, coverage ratios, and other relevant factors.

The Reserve for Unfunded Commitments

The Unfunded Reserve was $5.9 million as of March 31, 2015, unchanged from December 31, 2014. The process used to determine the Unfunded Reserve is consistent with the process for determining the Allowance, as adjusted for estimated funding probabilities.

Table of Contents

Market Risk

Market risk is the potential of loss arising from adverse changes in interest rates and prices. We are exposed to market risk as a consequence of the normal course of conducting our business activities. Our market risk management process involves measuring, monitoring, controlling, and mitigating risks that can significantly impact our statements of income and condition. In this management process, market risks are balanced with expected returns in an effort to enhance earnings performance, while limiting volatility.

Our primary market risk exposure is interest rate risk.

Interest Rate Risk

The objective of our interest rate risk management process is to maximize net interest income while operating within acceptable limits established for interest rate risk and maintaining adequate levels of funding and liquidity. The potential cash flows, sales, or replacement value of many of our assets and liabilities, especially those that earn or pay interest, are sensitive to changes in the general level of interest rates. This interest rate risk arises primarily from our core business activities of extending loans and accepting deposits. Our investment securities portfolio is also subject to significant interest rate risk.

Many factors affect our exposure to changes in interest rates, such as general economic and financial conditions, customer preferences, historical pricing relationships, and repricing characteristics of financial instruments. Our earnings are affected not only by general economic conditions, but also by the monetary and fiscal policies of the U.S. and its agencies, particularly the Federal Reserve Bank (the “FRB”). The monetary policies of the FRB can influence the overall growth of loans, investment securities, and deposits and the level of interest rates earned on assets and paid for liabilities.

In managing interest rate risk, we, through the Asset/Liability Management Committee (“ALCO”), measure short and long-term sensitivities to changes in interest rates. The ALCO, which is comprised of members of executive management, utilizes several techniques to manage interest rate risk, which include:

- adjusting the balance sheet mix or altering the interest rate characteristics of assets and liabilities;
- changing product pricing strategies;
- modifying characteristics of the investment securities portfolio; and
- using derivative financial instruments.

Our use of derivative financial instruments, as detailed in Note 11 to the Consolidated Financial Statements, has generally been limited. This is due to natural on-balance sheet hedges arising out of offsetting interest rate exposures from loans and investment securities with deposits and other interest-bearing liabilities. In particular, the investment securities portfolio is utilized to manage the interest rate exposure and sensitivity to within the guidelines and limits established by the ALCO. We utilize natural and offsetting economic hedges in an effort to reduce the need to employ off-balance sheet derivative financial instruments to hedge interest rate risk exposures. Expected movements in interest rates are also considered in managing interest rate risk. Thus, as interest rates change, we may use different techniques to manage interest rate risk.

A key element in our ongoing process to measure and monitor interest rate risk is the utilization of an asset/liability simulation model that attempts to capture the dynamic nature of the balance sheet. The model is used to estimate and measure the balance sheet sensitivity to changes in interest rates. These estimates are based on assumptions about the behavior of loan and deposit pricing, repayment rates on mortgage-based assets, and principal amortization and maturities on other financial instruments. The model’s analytics include the effects of standard prepayment options on

mortgages and customer withdrawal options for deposits. While such assumptions are inherently uncertain, we believe that our assumptions are reasonable.

---

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

We utilize net interest income simulations to analyze short-term income sensitivities to changes in interest rates. Table 19
presents, for the twelve months subsequent to March 31, 2015 and December 31, 2014, an estimate of the change in net interest income that would result from a gradual and immediate change in interest rates, moving in a parallel fashion over the entire yield curve, relative to the measured base case scenario. The base case scenario assumes the balance sheet and interest rates are generally unchanged. Based on our net interest income simulation as of March 31, 2015, net interest income is expected to increase as interest rates rise. This is due in part to our strategy to maintain a relatively short investment portfolio duration. In addition, rising interest rates would drive higher rates on loans and induce a slower pace of premium amortization on certain securities within our investment portfolio. However, lower interest rates would likely cause a decline in net interest income as lower rates would lead to lower yields on loans and investment securities, as well as drive higher premium amortization on existing investment securities. Since deposit costs are already at low levels, lower interest rates are unlikely to significantly impact our funding costs. Based on our net interest income simulation as of March 31, 2015, net interest income sensitivity to changes in interest rates for the twelve months subsequent to March 31, 2015 was more sensitive compared to the sensitivity profile for the twelve months subsequent to December 31, 2014. The increase in sensitivity was partially due to changes in our balance sheet mix, including increases in funds sold, floating rate commercial loans, and core deposits.

Net Interest Income Sensitivity Profile — Table 19

	Impact on Future Annual Net Interest Income					
(dollars in thousands)	March 31, 2015			December 31, 2014		
Gradual Change in Interest Rates (basis points)						
+200	$10,993		2.8 %	$7,934		2.0 %
+100	5,399		1.4 %	3,740		1.0 %
-100	(7,059	)	-1.8 %	(6,528	)	-1.7 %
Immediate Change in Interest Rates (basis points)						
+200	$27,029		6.9 %	$18,962		4.8 %
+100	13,119		3.3 %	8,804		2.2 %
-100	(22,309	)	-5.7 %	(20,755	)	-5.3 %

To analyze the impact of changes in interest rates in a more realistic manner, non-parallel interest rate scenarios are also simulated. These non-parallel interest rate scenarios indicate that net interest income may decrease from the base case scenario should the yield curve flatten or become inverted for a period of time. Conversely, if the yield curve should steepen, net interest income may increase.

Other Market Risks

In addition to interest rate risk, we are exposed to other forms of market risk in our normal business transactions. Foreign currency and foreign exchange contracts expose us to a small degree of foreign currency risk. These transactions are primarily executed on behalf of customers. Our trust and asset management income are at risk to fluctuations in the market values of underlying assets, particularly debt and equity securities. Also, our share-based compensation expense is dependent on the fair value of our stock options, restricted stock units, and restricted stock at the date of grant. The fair value of stock options, restricted stock units, and restricted stock is impacted by the market price of the Parent’s common stock on the date of grant and is at risk to changes in equity markets, general economic conditions, and other factors.

Liquidity Risk Management

The objective of our liquidity risk management process is to manage cash flow and liquidity in an effort to provide continuous access to sufficient, reasonably priced funds. Funding requirements are impacted by loan originations and refinancings, deposit balance changes, liability issuances and settlements, and off-balance sheet funding commitments. We consider and comply with various regulatory guidelines regarding required liquidity levels and periodically monitor our liquidity position in light of the changing economic environment and customer activity. Based on periodic liquidity assessments, we may alter our asset, liability, and off-balance sheet positions. The ALCO monitors sources and uses of funds and modifies asset and liability positions as liquidity requirements change. This process, combined with our ability to raise funds in money and capital markets and through private placements, provides flexibility in managing the exposure to liquidity risk.

In an effort to satisfy our liquidity needs, we actively manage our assets and liabilities. We have immediate liquid resources in cash which is primarily on deposit with the FRB. Potential sources of liquidity also include investment securities in our available-for-sale securities portfolio, and our ability to sell loans in the secondary market and to secure borrowings from the FRB and FHLB. Our held-to-maturity securities, while not intended for sale, may also be utilized in repurchase agreements to

64

obtain funding. Our core deposits have historically provided us with a long-term source of stable and relatively lower cost source of funding. Additional funding is available through the issuance of long-term debt.

Maturities and payments on outstanding loans also provide a steady flow of funds. Additionally, as of March 31, 2015, investment securities with a carrying value of $180.7 million were due to contractually mature in one year or less. Liquidity is further enhanced by our ability to pledge loans to access secured borrowings from the FHLB and FRB. As of March 31, 2015, we could have borrowed an additional $747.5 million from the FHLB and an additional $647.6 million from the FRB based on the amount of collateral pledged.

We continued our focus on maintaining a strong liquidity position throughout the first three months of 2015. As of March 31, 2015, cash and cash equivalents were $775.5 million, the carrying value of our available-for-sale investment securities was $2.3 billion, and total deposits were $13.0 billion. As of March 31, 2015, we maintained our excess liquidity primarily in municipal bond holdings and mortgage-backed securities issued by Ginnie Mae. As of March 31, 2015, our available-for-sale investment securities portfolio was comprised of securities with an average base duration of approximately 2.7 years.

Capital Management

We actively manage capital, commensurate with our risk profile, to enhance shareholder value. We also seek to maintain capital levels for the Company and the Bank at amounts in excess of the regulatory "well-capitalized" thresholds. Periodically, we may respond to market conditions by implementing changes to our overall balance sheet positioning to manage our capital position.

The Company and the Bank are each subject to regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements could cause certain mandatory and discretionary actions by regulators that, if undertaken, would likely have a material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative and qualitative measures. These measures were established by regulation intended to ensure capital adequacy. As of March 31, 2015, the Company and the Bank were considered “well capitalized” under this regulatory framework. The Company’s regulatory capital ratios are presented in Table 20 below. There have been no conditions or events since March 31, 2015 that management believes have changed either the Company’s or the Bank’s capital classifications.

As of March 31, 2015, shareholders' equity was $1.1 billion, an increase of $20.2 million or 2% from December 31, 2014. For the first three months of 2015, net income of $42.4 million, common stock issuances of $3.3 million, shared-based compensation of $1.8 million and other comprehensive income of $5.5 million were partially offset by cash dividends paid of $19.7 million, and common stock repurchased of $13.1 million. In the first three months of 2015, included in the amount of common stock repurchased were 178,548 shares repurchased under our share repurchase program. These shares were repurchased at an average cost per share of $57.70 and a total cost of $10.3 million. From the beginning of our share repurchase program in July 2001 through March 31, 2015, we repurchased a total of 52.2 million shares of common stock and returned a total of $1.93 billion to our shareholders at an average cost of $37.03 per share. As of March 31, 2015, remaining buyback authority under our share repurchase program was $62.9 million. From April 1, 2015 through April 14, 2015, the Parent repurchased an additional 36,000 shares of common stock at an average cost of $61.46 per share for a total of $2.2 million. Remaining buyback authority under our share repurchase program was $60.7 million as of April 14, 2015. The actual amount and timing of future share repurchases, if any, will depend on market and economic conditions, regulatory rules, applicable SEC rules, and various other factors.

In April 2015, the Parent's Board of Directors declared a quarterly cash dividend of $0.45 per share on the Parent's outstanding shares. The dividend will be payable on June 12, 2015 to shareholders of record at the close of business on May 29, 2015.

The final rules implementing the Basel Committee on Banking Supervision's ("BCBS") capital guidelines for U.S. banks became effective for the Company on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. As of March 31, 2015, the Company's capital levels remained characterized as "well-capitalized" under the new rules. See the "Regulatory Initiatives Affecting the Banking Industry" section below for further discussion on Basel III.

We continue to evaluate the potential impact that regulatory rules may have on our liquidity and capital management strategies, including Basel III and those required under the Dodd-Frank Act. See the "Regulatory Initiatives Affecting the Banking Industry" section below for further discussion on the potential impact that these regulatory rules may have on our liquidity and capital requirements.

Table of Contents

Table 20 presents our regulatory capital and ratios as of March 31, 2015 and December 31, 2014.

Regulatory Capital and Ratios Table 20

(dollars in thousands)	March 31, 2015		December 31, 2014	
Regulatory Capital				
Shareholders' Equity	$1,075,251		$1,055,086	
Less: Goodwill [2]	27,422		31,517	
Defined Benefit Plans Adjustment	(33,895	)	(34,115	)
Net Unrealized Gains (Losses) on Investment Securities [3]	12,723		15,984	
Other	(198	)	2,069	
Common Equity Tier 1 Capital	1,069,199		n/a	
Tier 1 Capital	1,069,199		1,039,631	
Allowable Reserve for Credit Losses	91,692		88,785	
Total Regulatory Capital [1]	$1,160,891		$1,128,416	
Risk-Weighted Assets [1]	$7,313,682		$7,077,035	
Key Regulatory Capital Ratios [1]				
Common Equity Tier 1 Capital Ratio	14.62	%	n/a	%
Tier 1 Capital Ratio	14.62		14.69	
Total Capital Ratio	15.87		15.94	
Tier 1 Leverage Ratio	7.17		7.13	

[1] March 31, 2015 calculated under Basel III rules, which became effective January 1, 2015.

[2] March 31, 2015 calculated net of deferred tax liabilities.

[3] March 31, 2015 includes unrealized gains and losses related to the Company's reclassification of available-for-sale investment securities to the held-to-maturity category.

Regulatory Initiatives Affecting the Banking Industry

Basel III

The FRB and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's (“BCBS”) capital guidelines for U.S. banks. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Company. The rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio of Total Capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increase each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revise the definition and calculation of Tier 1 capital, Total Capital, and risk-weighted assets.

The phase-in period for the final rules became effective for the Company on January 1, 2015, with full compliance with all of the final rules’ requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. As of March 31, 2015, the Company's capital levels remained characterized as "well-capitalized" under the new rules.

On September 3, 2014, the FRB, the FDIC, and the Office of the Comptroller of the Currency finalized the Liquidity Coverage Ratio (“LCR”), which would require banks to hold highly liquid assets relative to cash outflows over a 30-day period during a stressed scenario. The LCR will generally apply to banking organizations with over $50.0 billion in assets, and therefore, should not directly impact the Company.

The Company is mindful of the pending development of the net stable funding ratio and short-term wholesale funding requirements, and other potential liquidity risk management and reporting requirements. Management will continue to monitor these developments and their potential impact to the Company's liquidity requirements.

Stress Testing

The Dodd-Frank Act requires federal banking agencies to issue regulations that require banks with total consolidated assets of more than $10.0 billion to conduct and publish company-run annual stress tests to assess the potential impact of different scenarios on the consolidated earnings and capital of each bank and certain related items over a nine-quarter forward-looking planning horizon, taking into account all relevant exposures and activities. On October 9, 2012, the FRB published final rules implementing the stress testing requirements for banks, such as the Company, with total consolidated assets of more than $10.0 billion but less than $50.0 billion. These rules set forth the timing and type of stress test activities, as well as rules governing controls, oversight and disclosure.

In March 2014, the FRB, OCC, and FDIC issued final supervisory guidance for these stress tests. This joint final supervisory guidance discusses supervisory expectations for stress test practices, provides examples of practices that would be consistent with those expectations, and offers additional details about stress test methodologies. It also emphasizes the importance of stress testing as an ongoing risk management practice.

We submitted our latest stress testing results, utilizing data as of September 30, 2014, to the FRB on March 31, 2015. We are also required to make our first stress test-related public disclosure, utilizing data as of September 30, 2014, between June 15 and June 30, 2015.

Debit Card Interchange Fees

On July 31, 2013, a U.S. District Court judge declared invalid provisions of the rule issued by the FRB under the Durbin Amendment of the Dodd-Frank Act, regarding the amount of the debit card interchange fee cap and the network non-exclusivity provisions, which was effective October 1, 2011. The court ruled that the FRB, when determining the amount of the fee cap, erred in using criteria outside the scope Congress intended to determine the fee cap, thereby causing the fee cap to be set higher than warranted. The court also ruled that the Durbin Amendment required merchants to be given a choice between multiple unaffiliated networks (signature and PIN networks) for each debit card transaction, as opposed to the FRB’s rule allowing debit card networks and issuers to make only one network available for each type of debit transaction. In September 2013, the U.S. District Court judge agreed to the FRB’s request to leave the existing rules in place until an appeals court rules on the case.

---

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

On March 21, 2014, a panel of the U.S. Court of Appeals for the District of Columbia (the "Court") overturned the U.S. District Court's opinion. The Court concluded that the FRB "reasonably interpreted the Durbin Amendment" to allow issuers to recover certain costs that are incremental to the authorization, clearing, and settlement ("ACS") costs. Finding that the FRB's interpretation was reasonable, the Court then analyzed whether the FRB reasonably concluded that issuers could recover the four specific costs challenged by the merchants: fixed ACS costs, network processing fees, fraud losses and transaction monitoring costs. The Court acknowledged that such a task was not "an exact science" and involved policy determinations in which the FRB had "expertise" as to which the FRB was entitled to "special deference." The Court remanded one issue relating to recovery of fraud-monitoring costs back to the FRB, asking it to articulate a reasonable justification for determining that transaction monitoring costs fell outside of the costs associated with fraud prevention. The Court also rejected the merchants' argument that the Durbin Amendment "unambiguously" required that there be multiple unaffiliated network routing options for each debit card transaction. The Court ruled that the FRB's final rule does exactly what Congress contemplated, which is that under the rule, issuers and networks are prohibited from restricting the number of payment card networks on which an electronic debit transaction may be processed to only affiliated networks. On August 18, 2014, some of the trade associations and retailers filed an appeal with the U.S. Supreme Court seeking review of the decision of the Court. On January 20, 2015, the U.S. Supreme Court announced it would not hear retailers' challenge to the FRB's debit card interchange fee rules. The U.S. Supreme Court's decision not to hear the case keeps intact the March 21, 2014 ruling by the Court. Management will continue to monitor the developments related to this matter and any potential impact on the Company's statements of income.

Operational Risk

Operational risk represents the risk of loss resulting from our operations, including, but not limited to, the risk of fraud by employees or persons outside the Company, errors relating to transaction processing and technology, failure to adhere to compliance requirements, and the risk of cyber security attacks. We are also exposed to operational risk through our outsourcing arrangements, and the effect that changes in circumstances or capabilities of our outsourcing vendors can have on our ability to continue to perform operational functions necessary to our business. The risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. Operational risk is inherent in all business activities, and management of this risk is important to the achievement of Company goals and objectives.

Our Operating Risk Committee (the "ORC") provides oversight and assesses the most significant operational risks facing the Company. We have developed a framework that provides for a centralized operating risk management function through the ORC, supplemented by business unit responsibility for managing operational risks specific to their business units. Our internal audit department also validates the system of internal controls through ongoing risk-based audit procedures and reports on the effectiveness of internal controls to executive management and the Audit and Risk Committee of the Board of Directors.

We continuously strive to strengthen our system of internal controls to improve the oversight of operational risk. While our internal controls have been designed to minimize operational risks, there is no assurance that business disruption or operational losses will not occur. On an ongoing basis, management reassesses operational risks, implements appropriate process changes, and invests in enhancements to our systems of internal controls.

Off-Balance Sheet Arrangements, Credit Commitments, and Contractual Obligations

Off-Balance Sheet Arrangements

We hold interests in several unconsolidated variable interest entities ("VIEs"). These unconsolidated VIEs are primarily low-income housing partnerships and solar energy partnerships. Variable interests are defined as contractual ownership or other interests in an entity that change with fluctuations in an entity's net asset value. The primary beneficiary consolidates the VIE. We have determined that the Company is not the primary beneficiary of these entities. As a result, we do not consolidate these VIEs.

Credit Commitments and Contractual Obligations

Our credit commitments and contractual obligations have not changed materially since previously reported in our Annual Report on Form 10-K for the year ended December 31, 2014.

13. Supplemental Guarantors Condensed Consolidating Financial Information (Unaudited)

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See the "Market Risk" section of MD&A.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company's management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of March 31, 2015. The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2015.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended March 31, 2015 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

Table of Contents

Part II - Other Information

Item 1A. Risk Factors

There are no material changes from the risk factors set forth under Part I, Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2014.

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

The Parent’s repurchases of its common stock during the first quarter of 2015 were as follows:
Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased [1]	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs [2]
January 1 - 31, 2015	127,089	$56.27	99,048	$ 67,681,665
February 1 - 28, 2015	71,192	59.30	69,500	63,554,487
March 1 - 31, 2015	28,945	61.15	10,000	62,944,109
Total	227,226	$57.84	178,548	

[1] During the first quarter of 2015, 48,678 shares were purchased from employees and/or directors in connection with stock swaps, income tax withholdings related to the vesting of restricted stock, and shares purchased for a deferred compensation plan. These shares were not purchased as part of the publicly announced program. The shares were purchased at the closing price of the Parent’s common stock on the dates of purchase.

[2] The share repurchase program was first announced in July 2001. As of March 31, 2015, $62.9 million remained of the total $2.0 billion total repurchase amount authorized by the Parent’s Board of Directors under the share repurchase program. The program has no set expiration or termination date.

Item 6. Exhibits

A list of exhibits to this Form 10-Q is set forth on the Exhibit Index and is incorporated herein by reference.

Table of Contents

Signatures

Pursuant to the requirements of Section 13 or 15(d) 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: April 20, 2015		Bank of Hawaii Corporation
	By:	/s/ Peter S. Ho Peter S. Ho Chairman of the Board, Chief Executive Officer, and President
	By:	/s/ Kent T. Lucien Kent T. Lucien Chief Financial Officer

Exhibit Index

Exhibit Number	
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as Amended, Adopted Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as Amended, Adopted Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive Data File