CENTRAL PACIFIC FINANCIAL CORP
Form 10-Q
August 11, 2008

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

FORM 10-Q

(Mark One)

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

or

£ 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 0-10777

CENTRAL PACIFIC FINANCIAL CORP.
(Exact name of registrant as specified in its charter)

Hawaii	99-0212597
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

220 South King Street, Honolulu, Hawaii 96813
(Address of principal executive offices) (Zip Code)

(808) 544-0500
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes T No £

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 Accelerated filer £ Non-accelerated filer Smaller reporting filer T £ company £

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes £ No T

The number of shares outstanding of registrant's common stock, par value $.01 per share, on August 1, 2008 was 28,723,983 shares.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Forward-Looking Statements

This document may contain forward-looking statements concerning projections of revenues, income, earnings per share, capital expenditures, dividends, capital structure, or other financial items, concerning plans and objectives of management for future operations, concerning future economic performance, or concerning any of the assumptions underlying or relating to any of the foregoing. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts, and may include the words “believes”, “plans”, “intends”, “expects”, “anticipate “forecasts” or words of similar meaning. While we believe that our forward-looking statements and the assumptions underlying them are reasonably based, such statements and assumptions are by their nature subject to risks and uncertainties, and thus could later prove to be inaccurate or incorrect. Accordingly, actual results could materially differ from projections for a variety of reasons, to include, but not limited to: the impact of local, national, and international economies and events (including natural disasters such as wildfires, tsunamis and earthquakes) on the Company’s business and operations and on tourism, the military, and other major industries operating within the Hawaii market and any other markets in which the Company does business; the impact of legislation affecting the banking industry; the impact of competitive products, services, pricing, and other competitive forces; movements in interest rates; loan delinquency rates and changes in asset quality; adverse conditions in the public debt market, the stock market or other capital markets, including any adverse changes in the price of the Company's stock; and a general deterioration in economic conditions, including the continued slowing of the real estate market. For further information on factors that could cause actual results to materially differ from projections, please see the Company’s publicly available Securities and Exchange Commission filings, including the Company’s Form 10-K for the last fiscal year. The Company does not update any of its forward-looking statements.

Item 1. Financial Statements

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in thousands)	June 30, 2008	December 31, 2007
Assets		
Cash and due from banks	$ 97,657	$ 79,088
Interest-bearing deposits in other banks	545	241
Federal funds sold	14,900	2,800
Investment securities:		
Trading	5,077	-
Available for sale	809,965	835,130
Held to maturity (fair value of $25,976 at June 30, 2008 and $46,077 at December 31, 2007)	26,023	46,124
Total investment securities	841,065	881,254
Loans held for sale	108,535	37,572
Loans and leases	4,077,956	4,141,705
Less allowance for loan and lease losses	86,050	92,049
Net loans and leases	3,991,906	4,049,656
Premises and equipment, net	82,724	82,841
Accrued interest receivable	22,687	26,041
Investment in unconsolidated subsidiaries	16,697	17,404
Other real estate	3,501	-
Goodwill	150,514	244,702
Core deposit premium	27,413	28,750
Mortgage servicing rights	13,622	11,222
Bank-owned life insurance	133,317	131,454
Federal Home Loan Bank stock	48,797	48,797
Income tax receivable	49,539	1,488
Other assets	46,930	37,076
Total assets	$ 5,650,349	$ 5,680,386
Liabilities and Shareholders' Equity		
Deposits:		
Noninterest-bearing demand	$ 649,950	$ 665,034
Interest-bearing demand	471,294	461,175
Savings and money market	1,151,821	1,178,855
Time	1,647,565	1,697,655
Total deposits	3,920,630	4,002,719
Short-term borrowings	275,186	16,000
Long-term debt	885,019	916,019
Minority interest	10,061	13,104
Other liabilities	52,350	58,141

Total liabilities	5,143,246	5,005,983
Shareholders' equity:		
Preferred stock, no par value, authorized 1,000,000 shares, none issued	-	-
Common stock, no par value, authorized 100,000,000 shares, issued and outstanding 28,716,667 shares at June 30, 2008 and 28,756,647 shares at December 31, 2007	402,985	403,304
Surplus	55,039	54,669
Retained earnings	63,321	222,644
Accumulated other comprehensive loss	(14,242)	(6,214)
Total shareholders' equity	507,103	674,403
Total liabilities and shareholders' equity	$ 5,650,349	$ 5,680,386

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(Amounts in thousands, except per share data)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Interest income:				
Interest and fees on loans and leases	$ 65,677	$ 77,070	$ 135,971	$ 153,236
Interest and dividends on investment securities:				
Taxable interest	9,308	8,866	18,579	17,578
Tax-exempt interest	1,416	1,365	2,805	2,728
Dividends	11	60	35	93
Interest on deposits in other banks	3	39	7	74
Interest on Federal funds sold and securities purchased under agreements to resell	22	109	43	119
Dividends on Federal Home Loan Bank stock	171	24	293	122
Total interest income	76,608	87,533	157,733	173,950
Interest expense:				
Interest on deposits:				
Demand	179	141	316	279
Savings and money market	2,980	6,166	6,765	12,452
Time	11,706	17,424	26,435	33,257
Interest on short-term borrowings	2,357	303	4,280	808
Interest on long-term debt	8,002	10,616	17,696	20,584
Total interest expense	25,224	34,650	55,492	67,380
Net interest income	51,384	52,883	102,241	106,570
Provision for loan and lease losses	87,800	1,000	122,072	3,600
Net interest income (loss) after provision for loan and lease losses	(36,416)	51,883	(19,831)	102,970
Other operating income:				
Service charges on deposit accounts	3,511	3,463	7,054	6,907
Other service charges and fees	3,710	3,414	7,125	6,771
Income from fiduciary activities	990	854	1,995	1,615
Equity in earnings of unconsolidated subsidiaries	131	167	414	424
Fees on foreign exchange	112	171	306	392
Investment securities gains	253	-	253	-
Loan placement fees	213	283	366	542
Net gain on sales of residential loans	2,241	1,403	4,039	2,770
Income from bank-owned life insurance	845	1,183	2,715	2,214
Other	(75)	600	1,943	1,055

Total other operating income	11,931	11,538	26,210	22,690
Other operating expense:				
Salaries and employee benefits	18,648	16,888	36,012	33,294
Net occupancy	3,266	2,593	6,119	5,097
Equipment	1,433	1,325	2,828	2,555
Amortization of core deposit premium	669	685	1,337	1,370
Amortization of mortgage servicing rights	612	500	1,113	1,010
Communication expense	1,125	938	2,210	2,086
Legal and professional services	2,615	2,110	5,028	4,437
Computer software expense	809	893	1,672	1,692
Advertising expense	700	635	1,382	1,258
Goodwill impairment	94,279	-	94,279	-
Foreclosed asset expense	3,984	-	6,574	-
Loss on sales of commercial real estate loans	1,671	-	1,671	-
Write down of assets	22,424	-	22,424	-
Other	8,048	4,764	9,094	9,008
Total other operating expense	160,283	31,331	191,743	61,807
Income (loss) before income taxes	(184,768)	32,090	(185,364)	63,853
Income tax expense (benefit)	(38,510)	11,074	(40,764)	22,702
Net income (loss)	$ (146,258)	$ 21,016	$ (144,600)	$ 41,151
Per share data:				
Basic earnings (loss) per share	$ (5.10)	$ 0.69	$ (5.04)	$ 1.34
Diluted earnings (loss) per share	(5.10)	0.68	(5.04)	1.33
Cash dividends declared	0.25	0.24	0.50	0.48
Shares used in computation:				
Basic shares	28,652	30,555	28,670	30,627
Diluted shares	28,652	30,798	28,670	30,894

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(Dollars in thousands)	Six Months Ended June 30, 2008	2007
Cash flows from operating activities:		
Net income (loss)	$ (144,600)	$ 41,151
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan and lease losses	122,072	3,600
Depreciation and amortization	3,881	3,515
Goodwill impairment	94,279	-
Write down of assets	22,424	-
Foreclosed asset expense	6,574	-
Amortization of intangible assets	2,450	2,380
Net amortization of investment securities	691	859
Share-based compensation	1,164	2,176
Net gain on investment securities	(253)	-
Deferred income tax expense (benefit)	(4,504)	4,363
Net gain on sales of residential loans	(4,039)	(2,770)
Loss on sale of commercial real estate loans	1,671	-
Proceeds from sales of loans held for sale	817,958	421,200
Originations of loans held for sale	(721,898)	(437,300)
Tax benefits from share-based compensation	(40)	-
Equity in earnings of unconsolidated subsidiaries	(414)	(424)
Increase in cash surrender value of bank-owned life insurance	(2,706)	(2,203)
Increase in income tax receivable	(48,051)	(2,660)
Net change in other assets and liabilities	(13,159)	(8,186)
Net cash provided by operating activities	133,500	25,701
Cash flows from investing activities:		
Proceeds from maturities of and calls on investment securities held to maturity	20,058	15,644
Proceeds from maturities of and calls on investment securities available for sale	311,868	394,853
Purchases of investment securities available for sale	(292,694)	(378,709)
Net loan originations	(351,783)	(95,126)
Proceeds from sales of loans originated for investment	64,901	-
Proceeds from sales of securitized residential mortgage loans	20,838	-
Proceeds from bank-owned life insurance	843	-
Purchases of premises and equipment	(3,764)	(4,296)
Distributions from unconsolidated subsidiaries	632	577
Contributions to unconsolidated subsidiaries	(845)	(2,668)
Acquisition of minority interests, net of cash acquired	(3,150)	-
Net cash used in investing activities	(233,096)	(69,725)
Cash flows from financing activities:		
Net increase (decrease) in deposits	(82,089)	70,374
Proceeds from long-term debt	30,000	150,000
Repayments of long-term debt	(60,736)	(72,693)
Net increase (decrease) in short-term borrowings	259,186	(77,405)

Cash dividends paid	(14,367)	(14,714)
Tax benefits from share-based compensation	40	-
Repurchases of common stock	(1,824)	(12,184)
Proceeds from issuance of common stock	350	250
Proceeds from stock option exercises	9	1,017
Net cash provided by financing activities	130,569	44,645
Net increase in cash and cash equivalents	30,973	621
Cash and cash equivalents at beginning of period	82,129	135,648
Cash and cash equivalents at end of period	$ 113,102	$ 136,269
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 61,371	$ 64,940
Income taxes	12,920	15,811
Supplemental disclosure of noncash investing and financing activities:		
Net change in common stock held by directors' deferred compensation plan	$ 44	$ 22
Net reclassification of loans to other real estate	7,401	-
Net transfer of loans to loans held for sale	162,984	-
Securitization of residential mortgage loans into trading mortgage backed securities	4,995	-

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Central Pacific Financial Corp. (referred to herein as “the Company,” “we,” “us,” or “our”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These interim condensed consolidated financial statements and notes should be read in conjunction with the Company’s consolidated financial statements and notes thereto filed on Form 10-K for the fiscal year ended December 31, 2007. In the opinion of management, all adjustments necessary for a fair presentation have been made and include all normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year.

Certain prior period amounts in the consolidated financial statements and the notes thereto have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net income (loss) or shareholders’ equity for any periods presented.

2. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

On January 1, 2008, we adopted the following new accounting pronouncements:

- SFAS 157 – Statement of Financial Accounting Standards No. 157, “Fair Value Measurements,”
- SFAS 159 – Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities,”
- EITF 06-10 – Emerging Issues Task Force Issue 06-10, “Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements,” and
- SAB 109 – Staff Accounting Bulletin No. 109, “Written Loan Commitments Recorded at Fair Value Through Earnings.”

The adoption of these pronouncements did not have a material impact on our consolidated financial statements.

In February 2008, the FASB amended SFAS 157 through the issuance of FSP FAS 157-2, “Effective Date of FASB Statement No. 157.” FSP FAS 157-2 is effective upon issuance and delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). As permitted under SFAS 157, we plan to adopt the provisions of SFAS 157 for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in our financial statements on a recurring basis effective January 1, 2009. We are evaluating the impact of the adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), “Business Combinations” (“SFAS 141(R)”). SFAS 141(R) establishes principles and requirements for how the acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest (minority interest) in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination or a gain from a bargain purchase and determining what information should be disclosed to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is to be applied prospectively to business combinations for which the acquisition date is on or after fiscal years beginning after December 15, 2008. We are currently assessing the impact of this pronouncement on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51” (“SFAS 160”). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. We are evaluating the impact of this pronouncement on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement 133” (“SFAS 161”). SFAS 161 enhances required disclosures regarding derivatives and hedging activities, including enhanced disclosures regarding how (a) an entity uses derivative instruments; (b) derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities; and (c) derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Specifically, SFAS 161 requires (1) disclosure of the objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation; (2) disclosure of the fair values of derivative instruments and their gains and losses in a tabular format; (3) disclosure of information about credit-risk-related contingent features; and (4) cross-reference from the derivative footnote to other footnotes in which derivative-related information is disclosed. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We are evaluating the impact of this pronouncement on our consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles” (“SFAS 162”). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. SFAS 162 is effective 60 days following the Securities and Exchange Commission’s approval of the Public Company Accounting Oversight Board amendments to AU Section 411. We are evaluating the impact of this pronouncement on our consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities” (FSP EITF 03-6-1”). FSP EITF 03-6-1 states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. We are evaluating the impact of this pronouncement on our consolidated financial statements.

3. LOANS AND LEASES

Loans, excluding loans held for sale, consisted of the following at the dates indicated:

(Dollars in thousands)	June 30, 2008	December 31, 2007
Commercial, Financial and Agricultural	$ 389,042	$ 385,521
Real Estate:		

Construction	1,092,426	1,226,138
Mortgage-Residential	1,084,685	1,036,702
Mortgage-Commercial	1,272,526	1,243,383
Consumer	196,590	209,166
Leases	53,307	53,303
	4,088,576	4,154,213
Unearned income	(10,620)	(12,508)
Total loans and leases	$ 4,077,956	$ 4,141,705

4. ALLOWANCE FOR LOAN AND LEASE LOSSES

The following table presents the changes in the allowance for loan and lease losses (the "Allowance") for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2008	2007	2008	2007
Balance, beginning of period	$ 72,108	$ 50,614	$ 92,049	$ 52,280
Provision for loan and lease losses	87,800	1,000	122,072	3,600
	159,908	51,614	214,121	55,880
Charge-offs	(74,257)	(843)	(129,067)	(5,678)
Recoveries	399	638	996	1,207
Net charge-offs	(73,858)	(205)	(128,071)	(4,471)
Balance, end of period	$ 86,050	$ 51,409	$ 86,050	$ 51,409

As a result of the downturn in the California residential construction market, which began in 2007 and has continued through the second quarter of 2008, some of our borrowers are finding it increasingly difficult to repay amounts due on their outstanding balances as they primarily rely on the proceeds received from the sales of homes to repay their loans. In turn, the collateral values securing some of these loans have significantly declined in value as evidenced by appraisals received in the first and second quarters of 2008. Current appraisals reflect market values that have dropped more than 50% from the market values indicated in appraisals obtained in the latter part of 2007. These factors have contributed to increases in the number of loan downgrades, nonaccrual loans, specific reserves on certain impaired loans and certain loan loss factors for specified pools of loans during the six months ended June 30, 2008. Additionally, our methodology for determining the adequacy of the Allowance has required that we increase our reserve levels on these loans.

Net charge-offs for the three and six months ended June 30, 2008 included charge-offs of loans transferred to loans held for sale of $51.0 million and $79.5 million, respectively, and were primarily concentrated on loans with direct exposure to the California residential construction market.

In July 2008, we reduced our exposure to the California residential construction market by selling certain non-performing assets with a combined carrying amount of $44.2 million at June 30, 2008. No gain or loss was recorded on the sale as the carrying values of these assets were written down to their sales price at June 30, 2008. Upon completion of the sale, our remaining asset exposure to the California residential construction sector was $102.1 million.

5. SECURITIZATIONS

During the second quarter of 2008, we securitized certain residential mortgage loans with an outstanding principal balance of $25.6 million that were previously held in our loan portfolio, with a U.S. Government sponsored entity. After the securitizations, we continued to hold mortgage-backed securities and service the residential mortgage loans. We recorded a servicing asset related to the securitizations of $0.3 million. At June 30, 2008, the unsold mortgage-backed securities that we received were categorized as trading securities and were therefore recorded at their fair value of $5.1 million. Any gains or losses realized on the sale of such securities and any subsequent changes in unrealized gains and losses are reported in our consolidated statement of operations.

6. GOODWILL AND OTHER INTANGIBLE ASSETS

The following table presents the changes in goodwill allocated to each of our reportable segments during the six months ended June 30, 2008:

(Dollars in thousands)	Hawaii Market	Commercial Real Estate	Total
Balance, beginning of period	$ 150,423	$ 94,279	$ 244,702
Additions	120	-	120
Reductions	(29)	-	(29)
Impairment charge	-	(94,279)	(94,279)
Balance, end of period	$ 150,514	$ -	$ 150,514

At June 30, 2008, we experienced a decline in our market capitalization which we determined to be an indicator that an impairment test was required under SFAS 142. As a result of the impairment test performed, we determined that the remaining goodwill associated with our Commercial Real Estate reporting segment was impaired and we recorded an impairment charge of $94.3 million in the second quarter of 2008.

Other intangible assets include a core deposit premium and mortgage servicing rights. The following table presents changes in other intangible assets for the six months ended June 30, 2008:

(Dollars in thousands)	Core Deposit Premium	Mortgage Servicing Rights
Balance, beginning of period	$ 28,750	$ 11,222
Additions	-	3,513
Amortization	(1,337)	(1,113)
Balance, end of period	$ 27,413	$ 13,622

The gross carrying value and accumulated amortization related to the core deposit premium and mortgage servicing rights are presented below:

	June 30, 2008			December 31, 2007		
(Dollars in thousands)	Gross Carrying Value	Accumulated Amortization	Net	Gross Carrying Value	Accumulated Amortization	Net
Core deposit premium	$ 44,642	$ (17,229)	$ 27,413	$ 44,642	$ (15,892)	$ 28,750
Mortgage servicing rights	24,033	(10,411)	13,622	20,520	(9,298)	11,222

Based on the core deposit premium and mortgage servicing rights held as of June 30, 2008, estimated amortization expense for the remainder of fiscal 2008, the next five succeeding fiscal years and all years thereafter are as follows:

	Estimated Amortization Expense	
(Dollars in thousands)	Core Deposit Premium	Mortgage Servicing Rights
2008 (remainder)	$ 1,337	$ 795
2009	2,674	1,730
2010	2,674	1,536
2011	2,674	1,351
2012	2,674	1,188
2013	2,674	1,044
Thereafter	12,706	5,978

$ 27,413	$ 13,622

Income generated as the result of new mortgage servicing rights is reported as gains on sales of loans and totaled $2.7 million and $3.5 million for the three and six months ended June 30, 2008, respectively, compared to $0.3 million and $0.6 million for the three and six months ended June 30, 2007, respectively. The fair value of our mortgage servicing rights was $14.5 million and $12.4 million at June 30, 2008 and December 31, 2007, respectively.

7. DERIVATIVES

In January 2008, we entered into a derivative transaction to hedge future cash flows from a portion of our then existing variable rate loan portfolio. Effective January 2008 through January 2013, we will receive payments equal to a fixed interest rate of 6.25% from the counterparty on a notional amount of $400 million. In return, we will pay to the counterparty a floating rate, namely our prime rate, on the same notional amount. The purpose of this derivative transaction is to minimize the risk of fluctuations in interest payments received on our variable rate loan portfolio. The derivative transaction has been designated as a cash flow hedge.

As required by SFAS 133, "Accounting for Derivative Instruments and Hedging Activities", we measure the derivative at fair value on our consolidated balance sheet. At each reporting period, depending on whether the derivative is in an asset or liability position, we record the derivative in other assets or other liabilities. We record the effective portion of the changes in the fair value of the derivative in accumulated other comprehensive income (loss), net of tax, until earnings are affected by the variability of cash flows of the hedged transaction. We immediately recognize the portion of the gain or loss in the fair value of the derivative that represents hedge ineffectiveness in current period earnings.

At June 30, 2008, the derivative was in a net liability position and we recorded the derivative at its fair value of $8.4 million in other liabilities. At June 30, 2008, we also recorded an unrealized loss of $8.4 million for the effective portion of the change in fair value of the derivative in accumulated other comprehensive income (loss). During the six months ended June 30, 2008, there was no hedge ineffectiveness.

8. SHARE REPURCHASE

In January 2008, the Company's board of directors authorized the repurchase and retirement of up to 1,200,000 shares of the Company's common stock (the "2008 Repurchase Plan"). Repurchases may be made from time to time on the open market or in privately negotiated transactions. During the six months ended June 30, 2008, we repurchased and retired a total of 100,000 shares of common stock for approximately $1.8 million. Although, a total of 1,100,000 shares remained authorized for repurchase under the 2008 Repurchase Plan at June 30, 2008, the Company is not currently making any repurchases.

9. SHARE-BASED COMPENSATION

The following table reflects total share-based compensation recognized for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2008	2007	2008	2007
Salaries and employee benefits	$ 553	$ 914	$ 1,164	$ 2,176
Income tax benefit	(222)	(366)	(467)	(872)
Net share-based compensation effect	$ 331	$ 548	$ 697	$ 1,304

In accordance with SFAS 123R, we are required to base initial share-based compensation expense on the estimated number of awards for which the requisite service and performance is expected to be rendered.

Stock Option Activity

The following is a summary of stock option activity for the Company's stock option plans for the six months ended June 30, 2008:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2008	872,912	$ 27.90
Changes during the period:		
Granted	95,000	18.75
Exercised	(1,000)	9.24
Expired	(2,213)	26.66
Forfeited	(36,249)	35.37
Outstanding at June 30, 2008	928,450	26.70

We estimate the fair value of stock options granted using the Black-Scholes option pricing formula and a single option award approach. This fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. The fair value of the Company's stock options granted to employees for the three and six months ended June 30, 2008 and 2007 was estimated using the following weighted-average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Expected volatility	32.5%	-%	32.0%	33.3%
Risk free interest rate	4.9%	-%	2.8%	4.5%
Expected dividends	8.0%	-%	5.4%	2.8%
Expected life (in years)	6.5	-	6.5	7.5
Weighted average fair value	$ 1.89	$ -	$ 3.47	$ 11.40

There were no stock options granted during the three months ended June 30, 2007.

Restricted Stock Awards

The table below presents the activity of restricted stock awards for the six months ended June 30, 2008:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2008	44,620	$ 34.87
Changes during the period:		
Forfeited	(2,500)	36.95
Nonvested at June 30, 2008	42,120	34.74

We awarded restricted stock awards to our non-officer directors and certain senior management personnel. The awards typically vest over a three or five year period. Compensation expense is measured as the market price of the stock awards on the grant date, and is recognized over the specified vesting periods.

Performance Shares and Stock Appreciation Rights

In 2005 and 2008, we established Long Term Incentive Plans (the "2005 LTIP" and "2008 LTIP") that covers certain executive and senior management personnel. Awards granted under the 2005 LTIP are comprised of three components: performance shares, stock appreciation rights ("SARs") and cash awards, while awards granted under the 2008 LTIP consists of performance shares and SARs. All performance shares and SARs awarded under both the 2005 LTIP and 2008 LTIP are granted from the Company's 2004 Stock Compensation Plan.

Performance shares granted under the 2005 LTIP vest based on achieving both performance and service conditions. Performance conditions require achievement of stated goals including earnings per share, credit quality and efficiency ratio targets. The service condition required employees to be employed continuously with the Company through March 15, 2008. The fair value of the grant to be recognized over this service period is determined based on the market value of the stock on the grant date, multiplied by the probability of the granted shares being earned. This requires us to assess the expectation over the performance period of the performance targets being achieved as well as to estimate expected pre-vested cancellations.

Performance shares granted under the 2008 LTIP vest based on achieving both market and service conditions. Market conditions require attainment of specified market-based conditions tied to the market value of our common stock. The service condition requires employees to be employed continuously with the Company through March 12, 2011. The fair value of the grant, which is based on the market value of the stock on the grant date, will be recognized as compensation over this service period and must be recognized as expense over the service period regardless of whether the market conditions are met, so long as the grantee meets the service condition.

The table below presents activity of performance shares for both the 2005 LTIP and 2008 LTIP during the six months ended June 30, 2008:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2008	45,957	$ 34.74
Changes during the period:		
Granted	97,907	18.88
Vested	(44,670)	34.77
Forfeited	(1,287)	33.86
Nonvested at June 30, 2008	97,907	18.88

SARs granted under the 2005 LTIP require the employee to achieve the same performance conditions as the performance shares described for above for the 2005 LTIP, as well as to satisfy service conditions that approximate three years from the date of grant. Similar to the performance shares under the 2005 LTIP addressed above, the amount of compensation cost to be recognized is the fair value of the SAR grant adjusted based on expectations of achieving the performance requirements and also the expected pre-vested cancellations. Compensation costs arising from the SARs will be recognized ratably over the requisite service period.

SARs granted under the 2008 LTIP require the achievement of the same market and service conditions described above for the 2008 LTIP. Similar to the performance shares awarded under the 2008 LTIP, the fair value of the SARs granted will be recognized as compensation over the service period and must be recognized as expense over the service period regardless of whether the market conditions are met, so long as the grantee meets the service condition.

Upon exercise of SARs under the 2005 LTIP and 2008 LTIP, for each SAR exercised, the grantee shall be entitled to receive value equal to the difference between the market value of a share on the date of exercise minus the market value of a share on the date of grant. We shall pay the value owing to the grantee upon exercise in whole shares. No cash will be awarded upon exercise, and no fractional shares will be issued or delivered.

As the Company’s SARs plan is a stock-settled SAR, this plan is an equity-classified award under SFAS 123R. As such, the financial and income tax accounting for this type of award is identical to that of a nonqualified stock option plan. Therefore, the grant date fair value for all SARs issued under the SARs plan is determined at the grant date using the same method as would be used for determining the fair value of a grant of a nonqualified stock option, which has historically been the Black-Scholes formula.

The fair value of SARs granted to employees were estimated using the Black-Scholes option pricing formula with the following weighted-average assumptions:

	Six Months Ended June 30, 2008	2007
Expected volatility	32.0%	31.7%
Risk free interest rate	2.8%	4.5%

Expected dividends	5.3%	2.8%
Expected life (in years)	6.5	6.5
Weighted average fair value	$ 3.50	$ 10.49

There were no grants of SARs for the three months ended June 30, 2008 and 2007.

The table below presents activity of SARs under both the 2005 LTIP and 2008 LTIP for the six months ended June 30, 2008:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2008	56,549	$ 35.00
Changes during the period:		
Granted	210,963	18.88
Vested	(21,368)	34.41
Forfeited	(5,893)	35.33
Outstanding at June 30, 2008	240,251	20.89

10. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Components of accumulated other comprehensive loss, net of taxes, were as follows:

(Dollars in thousands)	June 30, 2008	December 31, 2007
Unrealized holding losses on available-for-sale investment securities	$ (5,744)	$ (401)
Unrealized holding losses on derivatives	(8,428)	-
Pension adjustments	(9,596)	(9,973)
Tax effect	9,526	4,160
Accumulated other comprehensive loss, net of tax	$ (14,242)	$ (6,214)

The unrealized holding losses on available-for-sale investment securities at June 30, 2008 and December 31, 2007 represent net unrealized losses on U.S. Government sponsored entities debt and mortgage-backed securities, privately issued mortgage-backed securities and state and political subdivision municipal securities with total fair values of $423.0 million and $399.8 million, respectively. The declines in market value were primarily attributable to changes in interest rates and not credit quality. Because we have the ability and intent to hold all of our available-for-sale securities until a recovery of fair value, which may be at maturity, we do not consider these investments to be other-than-temporarily impaired.

Components of comprehensive income (loss) for the periods indicated were as follows:

(Dollars in thousands)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net income (loss)	$ (146,258)	$ 21,016	$ (144,600)	$ 41,151
Unrealized loss on investment securities, net of taxes	(7,147)	(4,883)	(3,202)	(3,078)
Unrealized loss on derivatives, net of taxes	(7,785)	-	(5,050)	-
Pension adjustments, net of taxes	113	328	224	328

Comprehensive income (loss)	$ (161,077)	$ 16,461	$ (152,628)	$ 38,401

11. PENSION PLANS

Central Pacific Bank, our bank subsidiary, has a defined benefit retirement plan (the "Pension Plan") which covers certain eligible employees. The plan was curtailed effective December 31, 2002, and accordingly, plan benefits were fixed as of that date. The following table sets forth the components of net periodic benefit cost for the Pension Plan:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2008	2007	2008	2007
Interest cost	$ 451	$ 446	$ 902	$ 892
Expected return on assets	(574)	(560)	(1,148)	(1,120)
Amortization of unrecognized loss	186	264	372	528
Net periodic cost	$ 63	$ 150	$ 126	$ 300

Central Pacific Bank also established Supplemental Executive Retirement Plans ("SERPs"), which provide certain officers of Central Pacific Bank with supplemental retirement benefits. The following table sets forth the components of net periodic benefit cost for the SERPs:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2008	2007	2008	2007
Service cost	$ 75	$ 140	$ 150	$ 280
Interest cost	138	136	276	272
Amortization of unrecognized transition obligation	5	5	10	10
Amortization of prior service cost	5	5	10	10
Amortization of unrecognized (gain) loss	(8)	1	(16)	2
Net periodic cost	$ 215	$ 287	$ 430	$ 574

12. EARNINGS PER SHARE

The following table presents the information used to compute basic and diluted earnings per share for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share data)	2008	2007	2008	2007
Net income	$ (146,258)	$ 21,016	$ (144,600)	$ 41,151
Weighted average shares outstanding - basic	28,652	30,555	28,670	30,627
Dilutive effect of employee stock options and awards	-	243	-	267
Weighted average shares outstanding - diluted	28,652	30,798	28,670	30,894
Basic earnings per share	$ (5.10)	$ 0.69	$ (5.04)	$ 1.34

Diluted earnings per share	$	(5.10)	$	0.68	$	(5.04)	$	1.33

A total of 1,308,728 potentially dilutive securities have been excluded from the dilutive share calculation for the three and six months ended June 30, 2008 as their effect was antidilutive, compared to 388,937 and 317,937 for the three and six months ended June 30, 2007, respectively.

13. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Effective January 1, 2008, we partially adopted the provisions of SFAS 157. The statement defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements for fair value measurements.

Under SFAS 157, we group our financial assets and liabilities at fair value into three levels based on the markets in which the financial assets and liabilities are traded and the reliability of the assumptions used to determine fair value as follows:

- Level 1 – Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities traded in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

- Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques that requires the use of significant judgment or estimation.

Under SFAS 157, we base our fair values on the price that we would expect to receive if an asset were sold or pay to transfer a liability in an orderly transaction between market participants at the measurement date. As required under SFAS 157, we maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements.

We use fair value measurements to record adjustments to certain financial assets and liabilities and to determine fair value disclosures. Available for sale securities and derivatives are recorded at fair value on a recurring basis. From time to time, we may be required to record other financial assets at fair value on a nonrecurring basis such as loans held for sale, impaired loans and mortgage servicing rights. These nonrecurring fair value adjustments typically involve application of the lower of cost or fair value accounting or write-downs of individual assets.

The following table below presents the balances of assets and liabilities measured at fair value on a recurring basis:

	June 30, 2008			
(Dollars in thousands)	Level 1	Level 2	Level 3	Total
Trading securities	$ -	$ 5,077	$ -	$ 5,077
Available for sale securities	955	794,461	14,549	809,965
Net Derivatives	-	(8,048)	-	(8,048)
Total	$ 955	$ 791,490	$ 14,549	$ 806,994

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	June 30, 2008
(Dollars in thousands)	Available For Sale Securities

Balance at January 1, 2008	$	14,821
Principal payments received on mortgage revenue bonds		(272)
Balance at June 30, 2008		14,549

For assets measured at fair value on a nonrecurring basis that were recorded at fair value on our balance sheet at June 30, 2008, the following table provides the level of valuation assumptions used to determine the respective fair values:

	June 30, 2008			
(Dollars in thousands)	Level 1	Level 2	Level 3	Total
Loans held for sale (1)	$ -	$ 72,394	$ -	$ 72,394
Impaired loans (1)	-	94,161	-	94,161

(1) Represents carrying value and related write-downs of loans for which adjustments are based
on agreed upon purchase prices for the loans or the appraised value of the collateral.

14. SEGMENT INFORMATION

We have three reportable segments: Commercial Real Estate, Hawaii Market and Treasury. The segments reported are consistent with internal functional reporting lines. They are managed separately because each unit has different target markets, technological requirements, marketing strategies and specialized skills. The Commercial Real Estate segment includes construction and real estate development lending in Hawaii, California and Washington. The Hawaii Market segment includes retail branch offices, commercial lending, residential mortgage lending and servicing, indirect auto lending, trust services and retail brokerage services. A full range of deposit and loan products and various other banking services are offered. The Treasury segment is responsible for managing the Company's investment securities portfolio and wholesale funding activities.

The All Others category includes activities such as electronic banking, data processing and management of bank owned properties.

The accounting policies of the segments are consistent with the Company's accounting policies that are described in Note 1 to the consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission. The majority of the Company's net income is derived from net interest income. Accordingly, management focuses primarily on net interest income, rather than gross interest income and expense amounts, in evaluating segment profitability.

Intersegment net interest income (expense) was allocated to each segment based upon a funds transfer pricing process that assigns costs of funds to assets and earnings credits to liabilities based on market interest rates that reflect interest rate sensitivity and maturity characteristics. All administrative and overhead expenses are allocated to the segments at cost. Cash, investment securities, loans and their related balances are allocated to the segment responsible for acquisition and maintenance of those assets. Segment assets also include all premises and equipment used directly in segment operations.

Segment profits and assets are provided in the following table for the periods indicated.

	Commercial Real Estate	Hawaii Market	Treasury	All Others	Total
			(Dollars in thousands)		
Three months ended June 30, 2008:					
Net interest income	$ 32,025	$ 19,969	$ (610)	$ -	$ 51,384
Intersegment net interest income (expense)	(20,838)	14,584	2,398	3,856	-
Provision for loan losses	(85,600)	(2,200)	-	-	(87,800)
Other operating income	119	10,585	1,235	(8)	11,931
Goodwill impairment	(94,279)	-	-	-	(94,279)
Other operating expense (excluding goodwill impairment)	(31,122)	(20,162)	(665)	(14,055)	(66,004)
Administrative and overhead expense allocation	(2,831)	(10,598)	(103)	13,532	-
Income taxes	42,187	(2,522)	(784)	(371)	38,510
Net income (loss)	$ (160,339)	$ 9,656	$ 1,471	$ 2,954	$ (146,258)
Three months ended June 30, 2007:					
Net interest income	$ 43,883	$ 12,690	$ (3,690)	$ -	$ 52,883
Intersegment net interest income (expense)	(27,656)	19,505	1,717	6,434	-
Provision for loan losses	(60)	(940)	-	-	(1,000)
Other operating income	67	9,282	2,309	(120)	11,538
Other operating expense	(1,729)	(16,453)	(565)	(12,584)	(31,331)
Administrative and overhead expense allocation	(1,806)	(9,252)	(444)	11,502	-
Income taxes	(4,382)	(5,118)	232	(1,806)	(11,074)
Net income (loss)	$ 8,317	$ 9,714	$ (441)	$ 3,426	$ 21,016
Six months ended June 30, 2008:					
Net interest income	$ 69,070	$ 37,080	$ (3,909)	$ -	$ 102,241
Intersegment net interest income (expense)	(45,301)	32,982	4,524	7,795	-
Provision for loan losses	(118,900)	(3,172)	-	-	(122,072)
Other operating income	177	21,543	4,214	276	26,210
Goodwill impairment	(94,279)	-	-	-	(94,279)
Other operating expense (excluding goodwill impairment)	(36,396)	(37,661)	(1,274)	(22,133)	(97,464)
Administrative and overhead expense allocation	(148)	(20,126)	(194)	20,468	-
Income taxes	50,325	(7,696)	(775)	(1,090)	40,764
Net income (loss)	$ (175,452)	$ 22,950	$ 2,586	$ 5,316	$ (144,600)
Six months ended June 30, 2007:					
Net interest income	$ 88,066	$ 24,927	$ (6,423)	$ -	$ 106,570
Intersegment net interest income (expense)	(54,370)	39,043	2,133	13,194	-
Provision for loan losses	(60)	(3,540)	-	-	(3,600)
Other operating income	81	18,365	4,205	39	22,690

Other operating expense	(3,591)	(33,940)	(1,214)	(23,062)	(61,807)
Administrative and overhead expense allocation	(3,591)	(16,312)	(528)	20,431	-
Income taxes	(9,447)	(10,137)	654	(3,772)	(22,702)
Net income (loss)	$ 17,088	$ 18,406	$ (1,173)	$ 6,830	$ 41,151
At June 30, 2008:					
Investment securities	$ -	$ -	$ 841,065	$ -	$ 841,065
Loans and leases (including loans held for sale)	2,180,792	2,005,699	-	-	4,186,491
Other	(54,255)	210,714	280,618	185,716	622,793
Total assets	$ 2,126,537	$ 2,216,413	$ 1,121,683	$ 185,716	$ 5,650,349
At December 31, 2007:					
Investment securities	$ -	$ -	$ 881,254	$ -	$ 881,254
Loans and leases (including loans held for sale)	2,228,739	1,950,538	-	-	4,179,277
Other	31,891	208,135	244,453	135,376	619,855
Total assets	$ 2,260,630	$ 2,158,673	$ 1,125,707	$ 135,376	$ 5,680,386

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

Overview

We are a Hawaii corporation and a bank holding company. Our principal business is to serve as a holding company for our bank subsidiary, Central Pacific Bank. We refer to Central Pacific Bank herein as "our Bank" or "the Bank," and when we say "the Company," "we," "us" or "our," we mean the holding company on a consolidated basis with the Bank and our other consolidated subsidiaries.

Central Pacific Bank is a full-service community bank with 39 branches and more than 95 ATMs located throughout the State of Hawaii. The Bank offers a broad range of products and services including accepting time and demand deposits and originating loans, including commercial loans, construction loans, commercial and residential mortgage loans, and consumer loans. The Bank also has four loan production offices serving customers in California.

On July 31, 2008, we announced that our Board of Directors elected Mr. Ronald K. Migita to succeed Mr. Clint Arnoldus as President and Chief Executive Officer of the Company and the Bank, effective August 1, 2008. Mr. Migita has been Chairman of the Board of Directors of the Company and the Bank since September 2004 and will continue to serve in those roles. Prior to joining the Company, Mr. Migita served as the President and Chief Executive Officer of CB Bancshares, Inc. whose principal subsidiary was City Bank, which merged with Central Pacific Financial in 2004. Mr. Migita's four decades of banking experience includes an extensive background in corporate and retail banking.

Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires that management make certain judgments and use certain estimates and assumptions that affect amounts reported and disclosures made. Accounting estimates are deemed critical when a different estimate could have reasonably been used or where changes in the estimate are reasonably likely to occur from period to period and would materially impact our consolidated financial statements as of or for the periods presented. Management has discussed the development and selection of the critical accounting estimates noted below with the Audit Committee of the Board of Directors, and the Audit Committee has reviewed the accompanying disclosures.

Allowance for Loan and Lease Losses

We maintain an allowance for loan and lease losses (the "Allowance") at an amount we expect to be sufficient to absorb probable losses inherent in our loan and lease portfolio based on a projection of probable net loan charge-offs. For loans classified as impaired, which includes nonaccrual loans, an estimated impairment loss is calculated. To estimate loan charge-offs on other loans, we evaluate the level and trend of nonperforming and potential problem loans and historical loss experience. We also consider other relevant economic conditions and borrower-specific risk characteristics, including current repayment patterns of our borrowers, the fair value of collateral securing specific loans, changes in our lending and underwriting standards and general economic factors, nationally and in the markets we serve, including the real estate market generally and the residential construction market. Estimated loss rates are determined by loan category and risk profile, and an overall required Allowance is calculated. Based on our estimate of the level of Allowance required, a provision for loan and lease losses (the "Provision") is recorded to maintain the Allowance at an appropriate level. During the current quarter, we increased certain loan loss factors assigned to portions of our portfolio in light of the current economic environment and overall uncertainty in the credit markets. If these loan loss factors had not been increased in the second quarter of 2008, the Provision of $87.8 million would have been lower by $15.5 million.

Since we cannot predict with certainty the amount of loan and lease charge-offs that will be incurred, and because the eventual level of loan and lease charge-offs are impacted by numerous conditions beyond our control, a range of loss estimates could reasonably have been used to determine the Allowance and Provision. In addition, various regulatory agencies, as an integral part of their examination processes, periodically review our Allowance. Such agencies may require that we recognize additions to the Allowance based on their judgments about information available to them at the time of their examination. Accordingly, actual results could differ from those estimates.

Loans Held for Sale

Loans held for sale consists of residential mortgage loans, as well as mainland commercial mortgage and construction loans. Residential mortgage loans classified as held for sale are carried at the lower of cost or fair value on an aggregate basis while mainland commercial mortgage and construction loans are recorded at the lower of cost or fair value on an individual basis.

Loans originated with the intent to be held in our portfolio are subsequently transferred to held for sale when a decision is made to sell these loans. At the time of a loan's transfer to the held for sale account, the loan is recorded at the lower of cost or fair value. Any reduction in the loan's value is reflected as a write-down of the recorded investment resulting in a new cost basis, with a corresponding reduction in the Allowance.

In subsequent periods, if the fair value of a loan classified as held for sale is less than its cost basis, a valuation adjustment is recognized in our consolidated statement of operations in other operating expense and the carrying value of the loan is adjusted accordingly. The valuation adjustment may be recovered in the event that the fair value increases, which is also recognized in the condensed consolidated financial statements in other operating expense.

The fair value of loans classified as held for sale are generally based upon quoted prices for similar assets in active markets, acceptance of firm offer letters with an agreed upon purchase prices, discounted cash flow models that takes into account market observable assumptions, or independent appraisals of the underlying collateral securing the loans.

Goodwill and Other Intangible Assets

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), we review the carrying amount of goodwill for impairment on an annual basis. Additionally, we perform an impairment assessment of goodwill and other intangible assets whenever events or changes in circumstances indicate that the carrying value of goodwill and other intangible assets may not be recoverable. Significant changes in circumstances can be both internal to our strategic and financial direction, as well as changes to the competitive and economic landscape.

Our impairment assessment of goodwill and other intangible assets involves the estimation of future cash flows and the fair value of reporting units to which goodwill is allocated. Estimating future cash flows and determining fair values of the reporting units is only an estimate and often involves the use of significant assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of the impairment charge.

During the second quarter of 2008, we determined that an impairment test was required under SFAS 142 as the negative effects of the continued deterioration in the California residential construction market contributed to a decrease in our market capitalization. As a result of our impairment test, we concluded that the remaining goodwill associated with our Commercial Real Estate reporting segment, which includes the California residential construction loan portfolio, was impaired and we recorded a non-cash charge of $94.3 million in the second quarter of 2008. Following this impairment charge, our remaining goodwill balance was $150.5 million at June 30, 2008, all of which was attributable to our Hawaii Market reporting segment.

Deferred Tax Assets and Tax Contingencies

We account for income taxes in accordance with SFAS 109, "Accounting for Income Taxes" and FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48").

Deferred tax assets and liabilities are recognized for the estimated future tax effects attributable to temporary differences and carryforwards. A valuation allowance may be required if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In determining whether a valuation allowance is necessary, we consider the level of taxable income in prior years, to the extent that carrybacks are permitted under current tax laws, as well as estimates of future taxable income and tax planning strategies that could be implemented to accelerate taxable income if necessary. If our estimates of future taxable income were materially overstated, or if our assumptions regarding the tax consequences of tax planning strategies were inaccurate, some or all of our deferred tax assets may not be realized, which would result in a charge to earnings.

We have established income tax contingencies reserves for potential tax liabilities related to uncertain tax positions. Tax benefits are recognized when we determine that it is more likely than not that such benefits will be realized. Where uncertainty exists due to the complexity of income tax statutes, and where the potential tax amounts are significant, we generally seek independent tax opinions to support our positions. If our evaluation of the likelihood of the realization of benefits is inaccurate, we could incur additional income tax and interest expense that would adversely impact earnings, or we could receive tax benefits greater than anticipated which would positively impact earnings.

Defined Benefit Retirement Plan

Defined benefit plan obligations and related assets of our defined benefit retirement plan are presented in Note 14 to the Consolidated Financial Statements for the year ended December 31, 2007 included in the Company's Annual Report on Form 10-K. In 2002, the defined benefit retirement plan was curtailed and all plan benefits were fixed as of that date. Plan assets, which consist primarily of marketable equity and debt securities, are typically valued using market quotations. Plan obligations and the annual pension expense are determined by independent actuaries through the use of a number of assumptions. Key assumptions in measuring the plan obligations include the discount rate and the expected long-term rate of return on plan assets. In determining the discount rate, we utilize a yield that reflects the top 50% of the universe of bonds, ranked in the order of the highest yield. Asset returns are based upon the anticipated average rate of earnings expected on the invested funds of the plans. At December 31, 2007, we used a weighted-average discount rate of 6.5% and an expected long-term rate of return on plan assets of 8.0%, which affected the amount of pension liability recorded as of year-end 2007 and the amount of pension expense to be recorded in 2008. For both the discount rate and the asset return rate, a range of estimates could reasonably have been used which would affect the amount of pension expense and pension liability recorded. A 0.25% change in the discount rate assumption would impact 2008 pension expense by $0.1 million and year-end 2007 pension liability by $0.7 million, while a 0.25% change in the asset return rate would impact 2008 pension expense by $0.1 million.

Financial Summary

Continued weakness in the California residential construction market and related declines in collateral values have significantly impacted our operating results during the first half of 2008. Net loss for the second quarter of 2008 was $146.3 million, or $5.10 per diluted share, compared to net income of $21.0 million, or $0.68 per diluted share, for the second quarter of 2007, while net loss for the first six months of 2008 was $144.6 million, or $5.04 per diluted share, compared to net income of $41.2 million, or $1.33 per diluted share in the comparable prior year period. Our results for the current quarter and first six months of 2008 were reflective of the challenging economic environment that we, along with many other financial institutions across the country, continue to experience.

The net loss recognized in the second quarter of 2008 included credit costs of $116.1 million and a non-cash goodwill impairment charge of $94.3 million associated with the write down of the remaining balance of goodwill related to our Commercial Real Estate reporting segment, as the deteriorating California residential construction market continues to impact our business. Credit costs during the current quarter included the provision for loan and lease losses of $87.8 million, write-downs of loans classified as held for sale of $22.4 million, write-downs of foreclosed property of $4.0 million and an increase to the reserve for unfunded loan commitments of $1.9 million. The non-cash goodwill impairment charge had no impact on our cash flows, tangible equity or regulatory capital and was due to the continued deterioration in the California residential construction market and the resultant decline in our market capitalization and asset values with exposure to this sector. Following the impairment charge, we do not have any goodwill associated with our mainland lending operations and the remaining goodwill on our books at June 30, 2008 is attributable to our Hawaii operations.

The following table presents annualized returns on average assets, average shareholders' equity, average tangible equity and basic and diluted earnings per share for the periods indicated. Average tangible equity is calculated as average shareholders' equity less average intangible assets which includes goodwill and core deposit premium. Average intangible assets were $271.5 million and $272.3 million for the three and six months ended June 30, 2008, respectively, and $324.0 million and $326.4 million for the three and six months ended June 30, 2007, respectively.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Return (loss) on average assets	(9.96) %	1.52%	(4.98) %	1.50%

Return (loss) on average shareholders' equity	(86.27) %	10.99%	(42.27) %	10.87%
Return (loss) on average tangible equity	(143.86) %	19.03%	(70.22) %	19.04%
Basic earnings (loss) per share	$ (5.10)	$ 0.69	$ (5.04)	$ 1.34
Diluted earnings (loss) per share	$ (5.10)	$ 0.68	$ (5.04)	$ 1.33

Material Trends

Hawaii’s economy is expected to remain flat in 2008 as the continued effects of several airline failures; the surge in fuel prices and the loss of a cruise ship have taken an effect on Hawaii’s tourism industry. Hawaii economists now predict small net declines in both real income and jobs this year, and higher inflation. Hawaii economists also predict that a significant recovery of the Hawaii economy will not begin until 2010, making for a relatively shallow but lengthy Hawai'i economic contraction.

Based upon the latest data and near term outlook, visitor industry growth has been revised downward from the prior forecast. Total arrivals are expected to decrease 3.0% in 2008, which is in contrast to a 1.0% projected increase in the previous November 2007 forecast. In 2008, visitor days are expected to decline 2.4% from fiscal 2007 and average daily spending is expected to increase 0.5% over the previous year.

Hawaii real personal income is expected to increase 0.8% in 2008, following a 1.5% increase in 2007. The state’s unemployment rate, which was tied for the sixth lowest jobless rate in the nation, was 3.8% in June 2008 compared to 3.2% at December 31, 2007. The job growth forecasted for 2008 was 0.4%.

The rate of home resales in the Hawaii housing market is expected to slow down through 2009. In June 2008, the number of single-family home resales on Oahu decreased by 25.7% while the median sales price decreased by 2.5% from a year ago. Despite the anticipated slowdown in home resales, the Hawaii housing market is expected to experience lower levels of price declines compared to the national housing market.

California’s economy continues to face pressure caused by falling home prices, tight credit conditions, dysfunctional financial markets and soaring food and energy prices. Job growth in 2008 is expected to decrease by 0.2% from 2007 levels, while, California real personal income is expected to increase 4.5% in 2008, compared to 5.9% in 2007 and 6.5% in 2006. California’s unemployment rate has increased to 6.9% in June 2008 from 5.9% in December 2007, further suggesting a weakening in the economy.

The residential real estate market in California continues to be affected by the current downturn and ongoing effects of the credit crisis. In June 2008, the number of single-family home resales in California increased 17.5%, while the median sales price decreased 37.7% from a year ago. The increase in sales activity and the significant decline in the median price over the past year are largely due to a dramatic shift in the sales mix since the onset of the credit crisis and the increase in the share of distressed sales in 2008. This trend of slightly higher sales activity with declining median prices are expected to continue for the remainder of 2008 as increases in distressed sales activities are anticipated.

As we have seen in the past year with the deteriorating market conditions of the California residential construction market, our results of operations in future periods may be significantly impacted by the economies in Hawaii, California or other markets we serve. Loan demand, deposit growth, provision for loan losses, asset quality, noninterest income and noninterest expense may be affected by changes in economic conditions. If the California and Hawaii residential real estate markets do not improve or continue to deteriorate, the California commercial real estate market begins to deteriorate, or the economic environments in Hawaii, California or other markets we serve suffer an adverse change or a material external shock, our results of operations may be negatively impacted.

Results of Operations

Net Interest Income

Net interest income, when expressed as a percentage of average interest earning assets, is referred to as "net interest margin." Interest income, which includes loan fees and resultant yield information, are expressed on a taxable equivalent basis using an assumed income tax rate of 35%. A comparison of net interest income on a taxable equivalent basis ("net interest income") for the three and six months ended June 30, 2008 and 2007 is set forth below.

	Three Months Ended June 30, 2008			Three Months Ended June 30, 2007		
(Dollars in thousands)	Average Balance	Average Yield/Rate	Amount of Interest	Average Balance	Average Yield/Rate	Amount of Interest
Assets						
Interest earning assets:						
Interest-bearing deposits in other banks	$ 700	1.71%	$ 3	$ 3,011	5.16%	$ 39
Federal funds sold & securities purchased under agreements to resell	4,385	2.04	22	8,276	5.27	109
Taxable investment securities (1)	710,653	5.25	9,319	732,966	4.87	8,926
Tax-exempt investment securities (1)	150,796	5.78	2,179	154,715	5.43	2,100
Loans and leases, net of unearned income (2)	4,346,980	6.07	65,677	3,984,070	7.76	77,070
Federal Home Loan Bank stock	48,797	1.40	171	48,797	0.20	24
Total interest earning assets	5,262,311	5.90	77,371	4,931,835	7.17	88,268
Nonearning assets	613,736			585,625		
Total assets	$ 5,876,047			$ 5,517,460		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 472,037	0.15%	$ 179	$ 441,674	0.13%	$ 141