

CB BANCSHARES INC/HI
Form 10-K
March 11, 2004

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 0-12396

CB BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Hawaii
(State of Incorporation)

99-0197163
(IRS Employer Identification No.)

201 Merchant Street Honolulu, Hawaii 96813
(Address of principal executive offices)

(Registrant's Telephone Number) (808) 535-2500

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, Par value \$1.00 per share

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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

The aggregate market value of registrant's Common Stock held by non-affiliates at June 30, 2003 was approximately \$248,667,000. As of January 31, 2004, registrant had outstanding 4,338,337 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

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Portions of the registrant's Proxy Statement for its annual meeting of shareholders to be held on April 29, 2004 are incorporated by reference into Part III and IV.

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K includes forward-looking statements within the meaning of the Securities Exchange Act of 1934, as amended by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included in this report that address results or developments that CB Bancshares, Inc. and consolidated subsidiaries (the Company) expects or anticipates will or may occur in the future, where statements are preceded by, followed by or included the words believes, plans, intends, expects, anticipates or similar expressions, including such things as: (i) business strategy; (ii) economic trends and market condition, particularly in Hawaii; (iii) the direction of interest rates and prepayment speeds of mortgage loans and mortgage-backed securities; (iv) the adequacy of the Company's allowances for credit and real estate losses based on credit risks inherent in the lending processes; (v) expansion and growth of the Company's business and operations; (vi) renewal of existing credit agreements with and availability of additional advances from the Federal Home Loan Bank of Seattle (the FHLB); and (vii) other matters are forward-looking statements. These statements are based upon certain assumptions and analyses made by the Company in light of its experience and its perception of historical trends, current conditions and expected future developments as well as other factors it believes are appropriate in the circumstances. These statements are subject to a number of risks and uncertainties, many of which are beyond the control of the Company, including international, national and local economic, market or business conditions; real estate market conditions, particularly in Hawaii; the opportunities (or lack thereof) that may be presented to and pursued by the Company; competitive actions by other companies; changes in laws and regulations; the effects of natural disasters, terrorist acts and wars; and other factors. Actual results could differ materially from those contemplated by these forward-looking statements. Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even substantially realized, and that they will have the expected consequences to or effects on the Company and its business or operations. Forward-looking statements made in this report speak as of the date hereof. The Company undertakes no obligation to update or revise any forward-looking statement in this report.

PART I

ITEM 1. BUSINESS

CB BANCSHARES, INC.

CB Bancshares, Inc. (the Parent Company) is a bank holding company which was incorporated in the State of Hawaii in 1980. As a bank holding company, the Parent Company has the flexibility to directly or indirectly engage in certain bank-related activities other than banking, subject to regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve Board or FRB). The Parent Company has three wholly-owned subsidiaries, City Bank (the Bank), Datatronix Financial Services, Inc. (Datatronix) and O.R.E., Inc. (inactive), which are discussed below.

Our Internet address is www.citybankhawaii.com. On our Investor Relations web site, which can be accessed through www.citybankhawaii.com, we post the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission: our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, our proxy statement related to our annual stockholders' meeting and any amendments to those reports or statements filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. All such filings on our Investor Relations web site are available free of charge.

CITY BANK

City Bank is a state-chartered bank organized under the laws of the State of Hawaii in 1959. The Bank is insured by the Federal Deposit Insurance Corporation (the FDIC), and provides full commercial banking services through 17 branches on the island of Oahu, 2 branches on the island of Hawaii, 2 branches on the island of Maui and 1 branch on the island of Kauai. These services include receiving demand, savings and time deposits; making commercial, real estate and consumer loans; financing leases; financing international trade activities; issuing letters of credit; handling domestic and foreign collections; selling travelers' checks and bank money orders; and renting safe deposit boxes.

The Bank's primary focus has been corporate lending to small- to medium-sized businesses by maintaining relationships and expertise within business segments and providing personal customer service. The Bank intends to continue to develop and enhance the expertise of the corporate sales force and to leverage these corporate relationships to generate core deposit growth. The Bank has linked the corporate and wholesale lending to the retail banking group with the intent of developing seamless service between the corporate loan officers and the branch personnel and to increase cross-sale opportunities between business and retail customers. The Bank has commenced implementing its customer relationship management program which it believes will significantly enhance this effort.

The Bank also plans to further develop its electronic banking activities by continuing to enhance internet banking capability for both business and retail customers.

DATATRONIX FINANCIAL SERVICES, INC.

Datatronix, a wholly-owned subsidiary, was incorporated in the State of Hawaii in June 2000. Datatronix offers item processing services to banks, thrifts and other financial institutions in the State of Hawaii and California. As of December 31, 2003, Datatronix had six customers, with the Bank as its primary customer.

BUSINESS SEGMENTS

The Company's business segments are defined as Retail Banking, Wholesale Banking, Treasury and All Others. Retail Banking is made up of retail deposits, mortgage banking and consumer lending activities. Wholesale Banking consists of wholesale deposits, commercial real estate lending, corporate lending and the specialized lending functions of the Bank. The Treasury segment is responsible for managing the Company's investment securities portfolio and borrowing. The All Other segment consists of the administrative support of the Company. Additional financial and other information about the Company's business segments is presented in the Segments Discussion section of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and Note V of Notes to the Consolidated Financial Statements.

FHLB BORROWINGS

A primary source of borrowings for the Company is advances from the FHLB. The Bank has credit line agreements allowing for both short- and long-term advances. The agreements permit the Bank to borrow up to 35% of total qualified assets, provided that adequate mortgage loans or investment securities are pledged as collateral. At December 31, 2003, the Bank had \$305.0 million in short-term advances from the

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FHLB maturing from August 2004 to December 2004 with rates from 1.10% to 1.49%, and \$194.4 million in long-term advances from the FHLB ranging in maturity from January 2004 to September 2014 with rates from 2.26% to 8.22%. Advances are priced at the date of advance as either fixed or variable based. See the Liquidity section of Management's Discussion and Analysis as well as Notes H and I of Notes to the Company's Consolidated Financial Statements for further information.

COMPETITION AND ECONOMIC ENVIRONMENT

The earnings and growth of the Company are affected by the changes in the monetary and fiscal policies of the United States (the U.S.), as well as by local, national and international economic conditions. The overall growth of loans and investments, deposit levels and interest rates are directly influenced by the monetary policies of the Federal Reserve System. Since these changes are generally unpredictable, it is difficult to ascertain the impact of such future changes on the operations of the Company and its subsidiaries.

The banking business is highly competitive. The Bank competes for deposits and loans with five other commercial banks (the Bank is the fourth largest of the five commercial banks) and two other savings associations located in Hawaii. In addition to other commercial banks and savings associations, the Bank competes for savings and time deposits and certain types of loans with other financial institutions, such as consumer finance companies, credit unions, merchandise retailers, and a variety of financial service and advisory companies. The Bank also competes for mortgage loans with insurance and mortgage companies.

The economy of Hawaii is supported principally by tourism, governmental expenditures (primarily for the military), construction, and agriculture. The government has made certain strides in attempting to broaden the state's economic base in the areas of diversified agriculture, biotechnology, information technology and film. A small island economy like that of Hawaii, which significantly depends on imports for consumption, is greatly influenced by the changes in external economic conditions. A key to the economic performance of the state is the health of the U.S. and Japan economies and, to a lesser extent, the economies of Canada, Europe and other Asian nations. With the continued global instability and geopolitical issues in the Middle East and Asia, the Hawaii economy and many businesses are vulnerable to another economic downturn.

The events of September 11, 2001 have had a significant negative impact on the world, U.S. and Hawaii economies. Due to its dependence on tourism, Hawaii has been significantly affected by these events. However, during 2003, the state's tourism industry showed slight improvement over 2002, with total visitor days increasing by 3.0%. At December 31, 2003, Hawaii's unemployment rate was 3.8%, as compared to 3.6% reported a year ago. This coincided with the increase of real personal income by approximately 3.5% over this same period. Another sector showing improvement in 2003 was the state's housing market, supported by low mortgage interest rates. Residential home sales in 2003 were a record \$3.5 billion, or a 35.1% increase, compared to \$2.6 billion in 2002. The 2003 median sales price for single family homes and condominiums increased by 13.4% and 15.1%, respectively. Private building permits were up 37.8% overall for the year through November 2003 compared with same period in 2002. The total population of the State of Hawaii grew by 1.4% from 2002 to 2003.

Given these positive trends in key non-tourism sectors and overall economic indicators, the Hawaii economy is expected to grow moderately by 2.8% in 2004 excluding inflation. Future growth in Hawaii's economy is expected to be tied primarily to the rate of expansion in the mainland U.S. and Japan economies and increased military spending, and remains vulnerable to uncertainties in the world's geopolitical environment.

REGULATORY CONSIDERATIONS

The following discussion sets forth certain elements of the regulatory framework applicable to the Company. Federal and state regulation of financial institutions is intended primarily for the protection of depositors rather than shareholders of those entities. To the extent that the following discussion describes statutory or regulatory provisions, it is not intended to be complete and is qualified in its entirety by reference to the particular statutory or regulatory provisions, and any case law or interpretive letters concerning such provisions. In addition, there are other statutes and regulations that apply to and regulate the operation of the Company and its subsidiaries. Any change in applicable laws, or regulations, may have a material or possibly adverse effect on the business of the Company or other subsidiaries of the Company.

Bank Holding Company. The Parent Company is a bank holding company subject to supervision and regulations by the FRB under the Bank Holding Company Act of 1956, as amended (the BHCA). As a bank holding company, the Parent Company's activities and those of its banking and non-banking subsidiaries are limited to the business of banking and activities closely related or incidental to banking and to certain expressly permitted nonbanking activities. In addition, with certain exceptions, the Parent Company may not acquire, directly or indirectly, more than 5% of any class of the voting shares of, or substantially all of the assets of, a bank or any other company without the prior approval of the FRB.

The Bank. The Bank is organized under the laws of the State of Hawaii and is subject to significant regulations by the FDIC and the State of Hawaii Division of Financial Institutions of the Department of Commerce and Consumer Affairs. The Bank is also subject to significant federal and state regulations which materially affects its operations.

The Community Reinvestment Act. The Community Reinvestment Act (the CRA) requires lenders to identify the communities served by the Company s offices and to identify the types of credit the institution is prepared to extend within such communities. Under the CRA regulations of the FDIC and the other federal banking agencies, an institution s performance in making loans and investments and maintaining branches and providing services in low- and moderate-income areas within the communities that it serves is evaluated. In connection with its assessment of CRA performance, the FDIC assigns a rating of outstanding, satisfactory, needs to improve, or substantial noncompliance.

The Federal Home Loan Banks. Under the Federal Home Loan Bank Act, as amended, the ongoing stock investment requirement is equal to 0.3% of total assets, 1% of residential mortgages and mortgage-backed securities, or 5% of advances divided by the institution s Qualifying Assets Ratio (QAR), whichever is higher. The institution s QAR will determine a ratio of stock to borrowings (the higher the QAR, the lower the stock to borrowings requirement). The stock is recorded as a restricted investment security at par. Furthermore, FHLB advances must be collateralized with certain types of assets. Accordingly, the Company has pledged certain investments and loans to the FHLB as collateral for its advances.

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Dividend Restrictions. The principal source of the Parent Company's cash flow has been dividend payments received from the Bank. Dividends paid to the Parent Company by the Bank totaled \$11.8 million and \$5.8 million in 2003 and 2002, respectively. Under the laws of Hawaii, payment of dividends by the Bank is subject to certain restrictions, and payment of dividends by the Parent Company is likewise subject to certain restrictions.

The Company will continue to evaluate the dividend on a quarterly basis. In addition, applicable regulatory authorities are authorized to prohibit banks, thrifts and their holding companies from paying dividends which would constitute an unsafe and unsound banking practice. The FRB has indicated that it would generally be an unsafe and unsound banking practice for banks to pay dividends except out of current operating earnings. Furthermore, an insured depository institution, such as the Bank, cannot make a capital distribution (broadly defined to include, among other things, dividends, redemptions and other repurchases of stock), or pay management fees to its holding company if, thereafter, the depository institution would be undercapitalized.

Capital Standards. The Parent Company and the Bank are subject to capital standards promulgated by the FRB, the FDIC, and the Hawaii Division of Financial Institutions. The minimum ratio of total capital to risk-weighted assets, provided for in the guidelines adopted by the FRB, including certain off-balance-sheet items such as standby letters of credit, is 8%. At least half of the total capital is to be comprised of common equity, retained earnings, non-cumulative perpetual preferred stock, and a limited amount of cumulative perpetual preferred stock less goodwill (Tier 1 Capital). The remainder may consist of a limited amount of subordinated debt, other preferred stock, certain other instruments, and a limited amount of reserves for loan losses (Tier 2 Capital). The FDIC's risk-based capital guidelines for state non-member banks of the Federal Reserve System are generally similar to those established by the FRB for bank holding companies.

The FRB and FDIC also have adopted minimum leverage ratios for bank holding companies and banks requiring bank organizations to maintain a Leverage Ratio (defined as Tier 1 Capital divided by average total assets less goodwill) of at least 4% of total assets. The most highly rated banking organizations are expected to maintain an additional cushion of at least 100 basis points (1% equals 100 basis points), taking into account the level and nature of risk, to be allocated to the specific banking organizations by the primary regulator.

FRB guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets. Furthermore, the guidelines indicate that the FRB will continue to consider a tangible Tier 1 leverage ratio in evaluating proposals for expansion or new activities. The tangible Tier 1 leverage ratio is the ratio of a banking organization's Tier 1 Capital, less intangibles, to total assets, less intangibles.

Failure to meet capital guidelines could subject a bank to a variety of enforcement remedies, including the termination of deposit insurance by the FDIC, and to certain restrictions on its business, including restricting the payment of dividends. At December 31, 2003, the Company and the Bank exceeded applicable capital requirements. The consolidated capital position of the Parent Company at December 31, 2003 was as follows:

	<u>Company ratio</u>	<u>Minimum required ratio</u>
Risk-based Capital:		
Tier 1 capital ratio	11.03%	4.00%
Total capital ratio	12.29%	8.00%
Leverage ratio	8.90%	4.00%

Under FRB regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the FRB's policy that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of the FRB regulations, or both. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. Moreover, Congress has passed legislation pursuant to which depositors are granted a preference over all other unsecured creditors in the event of the insolvency of a bank or thrift.

Affiliate Transactions. Unless an exemption applies, sections 23A and 23B of the Federal Reserve Act and Regulation W thereunder (i) limit the extent to which a financial institution or its subsidiaries may engage in covered transactions with an affiliate, to an amount equal to 10% of such institution's capital and surplus and an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital and surplus and (ii) require that all transactions with an affiliate be on terms substantially the same, or at least as favorable to the institution or

subsidiary, as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and other similar types of transactions.

Safety and Soundness. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires each federal banking regulatory agency to prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating to: (i) internal controls, information systems and audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; (v) asset growth; (vi) compensation, fees and benefits; and (vii) such other operational and managerial standards as the agency determines to be appropriate. The compensation standards would prohibit employment contracts, compensation or benefit arrangements, stock option plans, fee arrangements or other compensatory arrangements that provide excessive compensation, fees or benefits or could lead to material financial loss. In addition, each federal banking regulatory agency must prescribe by regulation standards specifying: (i) a maximum ratio of classified assets to capital; (ii) minimum earnings sufficient to absorb losses without impairing capital to the extent feasible; (iii) a minimum ratio of market value to book value for publicly traded shares of depository institutions and depository institution holding companies; and (iv) such other standards relating to asset quality, earnings and valuation as the agency determines to be appropriate. If an insured depository institution or its holding company fail to meet any of the standards promulgated by regulations, then such company will be required to submit a plan to its federal regulator specifying the steps it will take to correct the deficiency. The federal banking agencies have uniform rules concerning these standards.

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Prompt Corrective Action. Under FDICIA, each federal banking agency is required to take prompt corrective action to resolve the problems of insured depository institutions that do not meet minimum capital ratios. The extent of an agency's power to take prompt corrective action depends upon whether an institution is well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized.

The federal banking agencies have adopted regulations to implement the prompt corrective action provisions of FDICIA. Under the regulations, an institution shall be deemed to be: (i) well-capitalized if it has total risk-based capital of 10% or more, has a Tier 1 risk-based capital ratio of 6% or more, has a Tier 1 leverage capital ratio of 5% or more and is not subject to any written agreement, order or directive to meet and maintain a specific capital level for any capital measure; (ii) adequately capitalized if it has a total risk-based capital ratio of 8% or more, a Tier 1 risk-based capital ratio of 4% or more and a Tier 1 leverage capital ratio of 4% or more (3% under certain circumstances) and does not meet the definition of well-capitalized; (iii) undercapitalized if it has a total risk-based capital ratio that is less than 8%, a Tier 1 risk-based capital ratio of 4% or more or a Tier 1 leverage capital ratio that is less than 4% (3% under certain circumstances); (iv) significantly undercapitalized if it has a total risk-based capital ratio that is less than 6%, a Tier 1 risk-based capital ratio that is less than 3% or a Tier 1 leverage capital ratio that is less than 3%; and (v) critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2%.

FDICIA authorizes the appropriate federal banking agency, after notice and an opportunity for a hearing, to treat an insured depository institution as if it had a lower capital-based classification if it is in an unsafe or unsound condition, engages in an unsafe or unsound practice or receives an unsatisfactory examination rating. Thus, a well-capitalized institution could be subjected to the restrictions of undercapitalized institutions.

An undercapitalized institution is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. The plan must specify: (i) the steps the institution will take to become adequately capitalized; (ii) the capital levels to be attained each year; (iii) how the institution will comply with any regulatory sanctions then in effect against the institution; and (iv) the types and levels of activities in which the institution will engage. An undercapitalized institution is also generally prohibited from paying any management fee or dividends to its holding company, increasing its average total assets and is generally prohibited from making any acquisitions, establishing any new branches or engaging in any new line of business except in accordance with an accepted capital restoration plan or with the approval of the FDIC.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the IBBEA) amended the BHCA to create certain interstate banking and branching opportunities. Under the IBBEA, a bank holding company may acquire a bank located in any state, provided that the acquisition does not result in the bank holding company controlling more than 10% of the deposits in insured depository institutions in the United States, or 30% of deposits in insured institutions in the state in which the bank to be acquired is located (unless the state waives the 30% deposit limitation or it is the initial entry into the state). The IBBEA permits individual states to restrict the ability of an out-of-state bank holding company or bank to acquire an in-state bank that has been in existence for less than five years and to establish a state concentration limit of less than 30% if such reduced limit does not discriminate against out-of-state bank holding companies or banks.

The IBBEA authorizes an adequately-capitalized bank, with the approval of the appropriate federal banking agency, to merge with another adequately-capitalized bank in any state that has not opted out of interstate branching. Such a bank may operate the target's offices as branches if certain conditions are satisfied. The same national and state deposit concentration limits and applicable state minimum-existence restrictions which apply to interstate acquisitions (as discussed above) also apply to interstate mergers. The applicant also must comply with any non-discriminatory host state filing and notice requirements and demonstrate a record of compliance with applicable federal and state community reinvestment laws. Hawaii enacted an interstate branching and bank mergers law which expressly permits interstate branching under Sections 102 and 103 of the IBBEA.

Under the IBBEA, the resulting bank in an interstate merger may establish or acquire additional branches at any location in a state where any of the banks involved in the merger could have established or acquired a branch. A bank also may acquire one or more branches of an out-of-state bank without acquiring the target out-of-state bank if the law of the target's home state permits such a transaction. In addition, the IBBEA permits a bank to establish a de novo branch in another state if the host state statutorily permits de novo interstate branching.

Hawaii law authorizes out-of-state banks to engage in interstate merger transactions (mergers and consolidations with and purchases of all or substantially all of the assets and branches of) with Hawaii banks, following which any such out-of-state bank may operate the branches of the Hawaii bank it has acquired. The Hawaii bank must have been in continuous operation for at least five years prior to such an acquisition, unless it is subject to or in danger of becoming subject to certain types of supervisory action. This statute does not permit out-of-state banks to acquire branches of Hawaii banks other than through an interstate merger transaction (except in the case of a bank that is subject to or in danger of becoming subject to certain types of supervisory action) nor to open branches in Hawaii on a de novo basis. Hawaii law imposes no state deposit caps or concentration limits. It also permits the State Commissioner of Financial Institutions to waive, on a case-by-case basis, federal statewide concentration limits, in accordance with standards that do not discriminate against out-of-state banks.

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The IBBEA also permits a bank subsidiary of a bank holding company to act as agent for other depository institutions owned by the same holding company for purposes of receiving deposits, renewing time deposits, closing or servicing loans and receiving loan payments.

Gramm-Leach Bliley Act. The Gramm-Leach-Bliley Act (the GLB Act) revised and expanded the existing BHCA and certain sections of the 1933 Glass-Steagall Act to permit a holding company system to engage in a full range of financial activities, including but not limited to, banking, insurance, securities, merchant banking and other activities incidental to financial services. The GLB Act permits the scope of financial and incidental activities to evolve with technology and competition. It also provides expanded financial affiliation opportunities for existing bank holding companies (BHC) and allows all financial holding companies to control a full-service insured bank. These expanded permissible activities are allowable for a BHC if it becomes a financial holding company (FHC). In order to become an FHC, a BHC must file a declaration with the FRB electing to engage in activities under the new BHCA Section 4(k) and certifying that it is eligible to do so because all of its insured depository institution subsidiaries are well-capitalized and well-managed. An institution is well-capitalized if it meets the primary regulator s definition for that status under the Federal Deposit Insurance Act for prompt corrective action purposes. Additionally, the FRB must determine that each depository institution controlled by an FHC has a satisfactory or better rating under the CRA in order for a company to become an FHC or for an FHC to engage in new financial activities or acquire, directly or indirectly, a company engaged in any

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activity under subsection (k) or (n). The FRB will be the overall regulatory agency and, along with the Department of Treasury, will have joint oversight to determine new financial activities of FHC companies. The Parent Company has not elected FHC status.

It is anticipated that this change in legislation will serve to provide consumers added convenience and savings as FHCs will be able to provide one-stop shops for financial services. It also provides for added privacy for consumers as policies on collecting, using and protecting personal financial information must be disclosed in writing to customers and customers will have the option to block information sharing with unaffiliated third parties, such as telemarketing companies.

Depository Insurance. The FDIC has a premium schedule under which the assessment rate for a bank depends upon the risk classification the FDIC assigns the institution. This allows institutions with improving capital positions to benefit from the improvement by lower assessments, while requiring those whose capital is falling to pay higher assessments. The FDIC may raise an institution's insurance premiums or terminate insurance altogether upon a finding that the institution has engaged in unsafe and unsound practices.

Other Regulatory Considerations. The Bank is also subject to a wide array of other state and federal laws and regulations, including, without limitation, usury laws, the Patriot Act, the Equal Credit Opportunity Act, the Electronic Funds Transfer requirements, the Truth-in-Lending Act, the Truth-in-Savings Act and the Real Estate Settlement Procedures Act.

UNSOLICITED TAKEOVER PROPOSAL

On April 16, 2003, Central Pacific Financial Corp., a Hawaii corporation (CPF), delivered an unsolicited proposal to merge with the Parent Company. CPF's proposal included the exchange of each share of the Parent Company's common stock outstanding for \$21 in cash and 1.8956 shares of CPF common stock.

On April 17, 2003, the Parent Company announced that it had received the proposal from CPF, and on April 23, 2003, it advised CPF that the Parent Company's Board would address the merger proposal promptly and in an orderly manner and would respond in a timely fashion. On April 23, the Parent Company also issued a press release announcing that it had engaged a financial advisor and legal counsel to assist its Board of Directors and management team in evaluating CPF's merger proposal.

On April 28, 2003, CPF filed a registration statement with the Securities and Exchange Commission in which it described its intent to commence an exchange offer for all outstanding shares of the Parent Company's common stock. On the same day, CPF filed applications with federal and state regulators in furtherance of its proposed exchange offer. Also on April 28, 2003, CPF delivered to the Parent Company a letter requesting a special meeting of shareholders of the Parent Company to vote on whether to approve CPF's acquisition of shares of the Parent Company's common stock pursuant to the proposed exchange offer under the Hawaii Control Share Acquisitions Act.

On April 29, 2003, the Parent Company announced that at its Board of Directors meeting held on April 23, 2003, the Board declared a 10% stock dividend and a cash dividend of \$0.12 per common share for the second quarter of 2003, payable on June 27, 2003 to stockholders of record on June 16, 2003. Similar 10% stock dividends were declared in the second quarters of 2001 and 2002.

On May 1, 2003, CPF announced that, in light of the 10% stock dividend announced by the Parent Company on April 29, it was amending its offer so that the per share amount of cash to be paid and number of shares of CPF common stock to be issued pursuant to the proposed offer to exchange was adjusted from \$21.00 to \$19.09 in cash and from 1.8956 to 1.7233 in shares of CPF common stock.

On May 2, 2003, CPF amended and supplemented its prior application submitted to the Division of Financial Institutions of the Department of Commerce & Consumer Affairs of Hawaii to include a request that the Commissioner of the Division approve CPF making a tender/exchange offer, pursuant to Section 412:3-612(a)(2) of the Hawaii Revised Statutes.

On May 4, 2003, the Board of Directors of the Parent Company met with senior management and independent financial and legal advisors to consider and discuss CPF's merger proposal and the Parent Company's response. After careful consideration, the Board concluded that the CPF proposal was inadequate and not in the best interests of the Parent Company. The Board of Directors of the Parent Company authorized the issuance of a press release and delivery of a letter to CPF communicating its determination. Accordingly, on May 4, 2003, the Parent Company issued a press release announcing the Board's unanimous rejection of CPF's proposal.

On May 5, 2003, the Parent Company received a letter from CPF requesting that the date of the special meeting be moved by three weeks, from May 28, 2003 to June 19, 2003. On May 7, 2003, the Parent Company delivered to CPF a letter rejecting CPF's request.

On May 9, 2003, CPF delivered a letter to the Parent Company purporting to rescind, revoke and withdraw its April 15 merger proposal and the related information statement delivered on April 28. In the same letter, CPF argued that in light of its withdrawal of its prior proposal, the special

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meeting scheduled for May 28 was moot and should be cancelled.

Also on May 9, 2003, CPF delivered a second letter to the Parent Company presenting a revised proposal pursuant to which the Parent Company's shareholders would receive 1.7606 shares of CPF common stock and \$24.50 in cash for each outstanding share of common stock (or 1.6005 shares and \$22.27 in cash per share of common stock on a post-stock dividend basis). This revised proposal did not materially modify the value of the total consideration offered by CPF, but only changed the mix of cash and stock consideration to be received per share of common stock.

On May 9, 2003, CPF also amended its registration statement on Form S-4 so that the consideration to be paid in its proposed offer to exchange would be the same as that to be paid pursuant to the proposal reflected in CPF's May 9 letter to the Parent Company.

On May 12, 2003, the Board of Directors of the Parent Company met with senior management and independent financial and legal advisors to consider and discuss CPF's revised proposal and the Parent Company's response. After careful consideration, the Board unanimously concluded that the revised proposal was inadequate and not in the best interests of the Parent Company. Following the Board meeting, the

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Parent Company issued a press release announcing the Board's unanimous decision. The Parent Company also advised CPF that the special meeting to consider CPF's control share acquisition would be held on May 28, 2003, as the Parent Company's Board had previously scheduled in accordance with Hawaii law and CPF's letter dated April 28, 2003.

On May 13, 2003, CPF delivered to the Parent Company a letter requesting that a special meeting of shareholders be held on June 26, 2003 to vote on CPF's control share acquisition proposal. CPF's letter was accompanied by letters executed by a number of the Parent Company's shareholders purporting to designate CPF as their agent to call a special meeting. The Parent Company believed that CPF's request was invalid because, among other things, a special meeting of shareholders had already been properly called by the Board of Directors of the Parent Company to consider the control share acquisition proposal. CPF disputed the Parent Company's position and maintained that the May 28 special meeting was moot.

On May 14, 2003, CPF filed a complaint against the Parent Company in the Hawaii State court seeking a temporary restraining order and preliminary injunction to prevent the Parent Company from holding the special meeting or taking any actions in furtherance of a solicitation in connection with the special meeting. On May 16, 2003, CPF's motion for a temporary restraining order was denied.

On May 28, 2003, the Parent Company announced that based on the proxies submitted to the independent inspector of elections at the May 28 special meeting, it believed that the Parent Company's shareholders rejected CPF's proposal to acquire a majority of the Parent Company's outstanding shares.

On May 28, 2003, the Parent Company also announced that its Board of Directors amended the Parent Company's shareholder rights plan to avoid a distribution of the rights as a result of CPF's invalid request for a special meeting. Under the plan as it existed prior to the amendment, a distribution of the rights would have resulted from CPF's obtaining authorizations to call a special shareholders meeting from the Parent Company's shareholders owning approximately 27% of the outstanding shares in a non-public solicitation. The amendment to the plan states that CPF will not be deemed to be the beneficial owner of the shares underlying any of these authorizations unless the authorization ultimately is delivered to the Parent Company for a valid and effective purpose under Hawaii law and the Parent Company's governing documents.

On June 12, 2003, the Parent Company announced that the independent inspectors of election certified the final results of the shareholder vote at the special meeting held on May 28, 2003, confirming that the Parent Company's shareholders rejected CPF's proposal to acquire a majority of the Parent Company's outstanding shares.

On June 17, 2003, CPF announced that it would not continue to pursue the special meeting of shareholders that CPF purported to call for June 26, 2003.

On June 28, 2003, the Parent Company announced that CPF withdrew all pending legal claims made against the Parent Company regarding the May 28, 2003 special shareholders' meeting. The Parent Company also announced that Circuit Court Judge Victoria Marks approved the stipulation dismissing CPF's complaint with prejudice, meaning its claims regarding the validity of the May 28 shareholders meeting cannot be re-filed.

On July 22, 2003, the Parent Company announced that it had filed a lawsuit in Hawaii State court against CPF asserting that CPF violated the Hawaii Control Share Acquisitions statute. The lawsuit alleged that CPF illegally formed a voting group with certain shareholders of the Parent Company without obtaining the approval of the Parent Company's shareholders as required by Hawaii law.

On July 30, 2003, CPF filed a complaint against the Parent Company in the Hawaii State court seeking to invalidate provisions of the Parent Company's new Rights Plan and bylaws, both adopted on July 23, 2003. CPF also seeks to enjoin the Parent Company from using its Rights Plans and bylaws.

On December 8 and December 9, 2003, the Division of Financial Institutions held a public hearing regarding CPF's application. On February 2, 2004, the Division of Financial Institutions approved CPF's application subject to certain conditions.

NUMBER OF EMPLOYEES

As of December 31, 2003, the Company and its subsidiaries employed 547 persons, 503 on a full-time basis and 44 on a part-time basis. Neither the Company nor any of its subsidiaries are a party to any collective bargaining agreements.

Table of Contents**STATISTICAL DISCLOSURES**

Guide 3 of the Securities Act Industry Guides sets forth certain statistical disclosures to be included in the Description of Business section of bank holding company filings with the Securities and Exchange Commission (the SEC).

The statistical information required is presented in the index shown below and as part of Items 6 or 7 of this Form 10-K for the fiscal year ended December 31, 2003. The tables and information contained therein have been prepared by the Company and have not been audited or reported upon by the Company's independent accountants.

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ITEM 2. PROPERTIES

The operations of the Bank are transacted through its main banking office and 22 other branches. The Company's facilities are located on leased premises, and expenditures by the Company for interior improvements are capitalized. The leases for these premises expire on various dates through the year 2035. Lease terms generally provide for additional payments for real property taxes, insurance and maintenance. See Note F of Notes to the Company's Consolidated Financial Statements.

ITEM 3. LEGAL PROCEEDINGS

Clarridge Complaint. On April 28, 2003, Barbara Clarridge (the Plaintiff) filed a complaint against the Parent Company and each of the members of the Parent Company's Board of Directors in the Circuit Court of the First Circuit, State of Hawaii. The case is denominated as a class action on behalf of all shareholders of the Parent Company although no proceedings have taken place regarding possible class certification. Plaintiff alleges, among other things, that the offer proposed by CPF is futile without approval of the Parent Company's directors because of the Parent Company's Rights Plan, and that the defendants have refused to seriously consider the CPF offer. The complaint seeks a judgment: (1) directing the defendants to give due consideration to any proposed business combination; (2) directing the defendants to assure that no conflicts of interest exist between the directors and their duties to the corporation; (3) awarding the plaintiff the costs and attorneys' fees; and (4) granting such other relief as the court deems proper.

On May 8, 2003, the Plaintiff filed a motion for preliminary injunction asking the court to: (1) enjoin indefinitely, until further order of the court, the special shareholders' meeting scheduled for May 28, 2003; (2) enjoin enforcement of the Bylaw amendment adopted May 4, 2003 regarding adjournment of shareholders' meetings; and (3) enjoin any further amendment to the Parent Company's Bylaws prior to the special shareholders meeting.

On May 23, 2003, the Parent Company announced that the court denied the Plaintiff's motion for a preliminary injunction to halt the Parent Company's May 28 special meeting of shareholders.

On July 14, 2003, Plaintiff filed a First Amended Complaint, in which she updated the complaint's factual allegations to reflect the results of the May 28, 2003 special shareholders meeting and alleged that the Parent Company's Directors had further breached their fiduciary duties by amending the Parent Company's Rights Plan on May 28, 2003.

On February 13, 2004, Plaintiff filed a Second Amended and Supplemental Complaint, in which she included allegations that the Parent Company's Directors had further breached their fiduciary duties by amending the Parent Company's Bylaws and Rights Plan on July 23, 2003 and adopting the 2003 Rights Agreement.

The Parent Company believes the claims are without merit and intends to defend against them vigorously.

CPF Complaints. On May 15, 2003, CPF filed a complaint against the Parent Company in the Circuit Court of the First Circuit, State of Hawaii seeking a temporary restraining order and preliminary injunction to stop the May 28, 2003 shareholders meeting called by the Parent Company to consider matters related to CPF's merger proposal. The suit also asked the court to: (1) declare the meeting in violation of Hawaii law; (2) find the meeting moot because CPF's first offer to the Parent Company had been revoked and withdrawn; and (3) stop the Parent Company from soliciting shareholder proxies for that May 28, 2003 meeting.

On May 16, 2003, the Hawaii State court denied CPF's motion for a temporary restraining order to block the Parent Company from providing its shareholders with proxy material regarding CPF's hostile takeover proposal.

On May 20, 2003, CPF withdrew, without prejudice, its motion for a preliminary injunction to stop the May 28, 2003 special shareholders meeting of the Parent Company.

On May 20, 2003, the Parent Company filed a counterclaim against CPF seeking injunctive and declaratory relief for CPF's violations of the Hawaii Control Share Acquisitions statute. The Parent Company alleges, among other things, that CPF violated Hawaii law by soliciting proxies well in advance of the statutory period - thirty days prior to a scheduled shareholder meeting - and that CPF failed to obtain shareholder approval, as required by statute, prior to acquiring beneficial ownership of more than ten percent of the outstanding shares of stock of the Parent Company.

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On June 28, 2003, the Parent Company announced that CPF withdrew all pending legal claims made against the Parent Company regarding the May 28, 2003 special shareholders meeting. The Parent Company also announced that Circuit Court Judge Victoria Marks approved the stipulation dismissing CPF's complaint with prejudice, which means CPF's claims regarding the validity of the May 28 shareholders meeting cannot be re-filed.

On June 30, 2003, CPF filed a motion to dismiss portions of the Parent Company's counterclaim. On August 6, 2003, CPF withdrew its motion to dismiss after the Circuit Court ruled that the Parent Company is entitled to take discovery in support of its remaining claims under the Hawaii Control Share Acquisition statute. On July 30, 2003, CPF filed a second complaint against the Parent Company in Circuit Court of the First Circuit, State of Hawaii seeking to invalidate provisions of the Parent Company's new Rights Plan and bylaws, both adopted on July 23, 2003. CPF also seeks to enjoin the Parent Company from using its Rights Plans and bylaws.

On August 19, 2003, CPF filed a motion for judgment on the pleadings in the Parent Company's counterclaim. CPF argued in the motion that the Hawaii Control Share Acquisitions statute could not be triggered by the voting agreement between CPF and the Parent Company's shareholders and that the statute was unconstitutional. On September 29, 2003, the court rejected CPF's arguments regarding the applicability and constitutionality of the statute and denied CPF's motion for judgment on the pleadings. Thus, the Parent Company's counterclaim remains in the first lawsuit filed by CPF, and was amended on October 31, 2003 to include additional allegations.

On December 18, 2003, CPF filed a counterclaim against the Parent Company and each of the members of the Parent Company's Board of Directors. CPF's counterclaim asks the court to (1) declare that the Parent Company's voting agreement with one of its shareholders, TON Finance, B.V. (TON), constitutes unlawful vote-buying; (2) declare that the Parent Company induced TON to breach its agreement with CPF in a manner constituting tortious interference with contract; (3) enjoin further such conduct by the Parent Company; (3) declare that the Parent

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Company's agreement with TON is null and void; and (4) in the alternative, impose monetary damages. CPF's counterclaim has been served on the Parent Company, but has not yet been served on the members of the Parent Company's Board of Directors.

The parties have commenced the discovery process in both CPF lawsuits, including the production of documents and oral depositions.

The Parent Company's Complaint. On July 22, 2003, the Parent Company announced that it had filed a lawsuit in the Circuit Court of the First Circuit, State of Hawaii against CPF asserting that CPF violated the Hawaii Control Share Acquisitions statute. The lawsuit alleges that CPF illegally formed a voting group with certain shareholders of the Parent Company without obtaining the approval of the Parent Company's shareholders as required by Hawaii law.

On August 19, 2003, CPF filed a motion to dismiss the Parent Company's complaint. CPF argued in the motion that the complaint was duplicative of the Parent Company's counterclaim asserted in the first lawsuit filed by CPF, that the Hawaii Control Share Acquisitions statute could not be triggered by voting agreements or arrangements between CPF and the Parent Company's shareholders, and that the statute was unconstitutional. On September 29, 2003, the court denied the motion to dismiss on the substantive arguments, but granted the motion in part based on procedural grounds, finding similar claims had already been filed in the Parent Company's counterclaim in the first CPF lawsuit. Thus, the Parent Company's lawsuit has been dismissed. However, in its ruling the court specifically granted the Parent Company leave to file an amended counterclaim in the first lawsuit filed by CPF to include all additional allegations made in the Parent Company's complaint. Therefore, all of the allegations made in the Parent Company's lawsuit have been incorporated in the amended counterclaim, which was filed on October 31, 2003.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted during the fourth quarter of 2003 to a vote of security holders through the solicitation of proxies or otherwise.

PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

The Parent Company's common stock is traded on the NASDAQ National Market System under the symbol CBB1. At March 1, 2004, the Parent Company had approximately 3,500 common shareholders of record.

The following table sets forth quarterly high and low bid and dividend information on a per share basis for the Parent Company's common stock over the preceding two years. Common stock prices have been retroactively adjusted to reflect stock dividends:

	<u>High</u>	<u>Low</u>	<u>Dividends</u>
2003			
First quarter	\$45.28	\$36.68	\$0.11
Second quarter	61.73	40.74	0.12
Third quarter	62.27	58.83	0.36
Fourth quarter	64.50	59.61	0.36
2002			
First quarter	\$30.23	\$27.08	\$0.11
Second quarter	35.38	29.73	0.11
Third quarter	35.67	29.70	0.11
Fourth quarter	38.44	31.66	0.11

The Parent Company's ability to pay dividends is limited by certain restrictions generally imposed on Hawaii corporations. The Parent Company may pay dividends out of funds legally available at such times as the Board of Directors determines are appropriate.

The following table details the total number of shares available for issuance under the Company's employee stock-based incentive plans (including shares available for issuance to nonemployee directors). The Company is not authorized to grant stock-based incentive awards to

nonemployees other than to nonemployee directors.

	Number of shares to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of shares remaining available for future use under equity compensation plans
	<u> </u>	<u> </u>	<u> </u>
December 31, 2003			
Employee stock-based incentive plans approved by shareholders	366,791	\$ 36.35	233,650
Employee stock-based incentive plans not approved by shareholders			
Total	<u>366,791</u>		<u>233,650</u>

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA**

(dollars in thousands, except per share data)

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Income Statement Data:					
Interest income	\$ 103,010	\$ 106,945	\$ 128,254	\$ 132,472	\$ 111,233
Interest expense	23,416	30,292	57,448	71,478	52,717
Net interest income	79,594	76,653	70,806	60,994	58,516
Provision for credit losses	7,180	17,110	13,628	7,539	4,975
Net interest income after provision for credit losses	72,414	59,543	57,178	53,455	53,541
Noninterest income ⁽¹⁾	23,286	12,815	2,817	10,024	10,328
Noninterest expense ⁽²⁾	64,927	52,618	50,595	46,679	58,336
Income before income taxes	30,773	19,740	9,400	16,800	5,533
Income tax expense	10,025	6,258	3,250	5,582	5,227
Net income	\$ 20,748	\$ 13,482	\$ 6,150	\$ 11,218	\$ 306
Cash dividends	\$ 4,015	\$ 1,649	\$ 1,441	\$ 1,093	