

HERITAGE COMMERCE CORP
Form 10-Q
November 10, 2010

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

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended September 30, 2010

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 000-23877

Heritage Commerce Corp

(Exact name of Registrant as Specified in its Charter)

California
(State or Other Jurisdiction of
Incorporation or Organization)

77-0469558
(I.R.S. Employer
Identification No.)

150 Almaden Boulevard, San Jose, California
(Address of Principal Executive Offices)

95113
(Zip Code)

(408) 947-6900
(Registrant's Telephone Number, Including Area Code)

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES 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 filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a
smaller reporting company)

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

The Registrant had 26,233,001 shares of Common Stock outstanding on October 29, 2010.

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	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Assets		
Cash and due from banks	\$ 230,365	\$ 45,372
Federal funds sold	100	100
Interest-bearing deposits in other financial institutions	90	90
Total cash and cash equivalents	230,555	45,562
Securities available-for-sale, at fair value	111,459	109,966
Loans held-for-sale SBA, at lower of cost or market, including deferred costs	7,967	10,742
Loans held-for-sale Other, at lower of cost or market, including deferred costs	4,788	
Loans, including deferred costs	886,616	1,070,113
Allowance for loan losses	(25,290)	(28,768)
Loans, net	861,326	1,041,345
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	9,337	8,454
Company owned life insurance	43,255	42,313
Premises and equipment, net	8,577	9,006
Goodwill		43,181
Intangible assets	3,158	3,589
Accrued interest receivable and other assets	50,448	49,712
Total assets	\$ 1,330,870	\$ 1,363,870
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand, noninterest bearing	\$ 269,482	\$ 260,840
Demand, interest-bearing	156,912	146,828
Savings and money market	318,221	295,404
Time deposits under \$100	38,909	40,197
Time deposits \$100 and over	132,862	129,831
Time deposits CDARS	16,297	38,154
Time deposits brokered	132,435	178,031
Total deposits	1,065,118	1,089,285
Securities sold under agreement to repurchase	15,000	25,000
Subordinated debt	23,702	23,702
Short-term borrowings	4,315	20,000
Accrued interest payable and other liabilities	37,635	33,578
Total liabilities	1,145,770	1,191,565
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized		
Series A fixed rate cumulative preferred stock, 40,000 shares issued and outstanding (liquidation	39,846	39,846

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preference of \$42,300 at September 30, 2010 and \$40,783 at December 31, 2009)		
Discount on Series A preferred stock	(1,322)	(1,598)
Series C convertible perpetual preferred stock, 21,004 shares issued and outstanding at September 30, 2010 and none at December 31, 2009 (liquidation preference of \$21,004 at September 30, 2010)	19,538	
Common stock, no par value; 60,000,000 shares authorized; 26,233,001 shares issued and outstanding at September 30, 2010 and 11,820,509 shares issued and outstanding at December 31, 2009	131,329	80,222
Retained earnings / (Accumulated deficit)	(2,965)	56,389
Accumulated other comprehensive loss	(1,326)	(2,554)
Total shareholders' equity	185,100	172,305
Total liabilities and shareholders' equity	\$ 1,330,870	\$ 1,363,870

See notes to consolidated financial statements

Table of Contents**Heritage Commerce Corp****Consolidated Statements of Operations (Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
(Dollars in thousands, except per share data)				
Interest income:				
Loans, including fees	\$ 12,041	\$ 14,727	\$ 37,952	\$ 44,619
Securities, taxable	1,247	753	3,869	2,702
Securities, non-taxable		1		9
Interest-bearing deposits in other financial institutions	73	14	99	21
Total interest income	13,361	15,495	41,920	47,351
Interest expense:				
Deposits	1,929	3,228	6,451	10,652
Subordinated debt	473	476	1,407	1,463
Repurchase agreements	97	168	341	638
Short-term borrowings	31		93	53
Note payable				82
Total interest expense	2,530	3,872	8,292	12,888
Net interest income before provision for loan losses	10,831	11,623	33,628	34,463
Provision for loan losses	2,058	7,129	25,754	28,253
Net interest income after provision for loan losses	8,773	4,494	7,874	6,210
Noninterest income:				
Gain on sale of securities	1,492		1,492	
Service charges and fees on deposit accounts	536	557	1,664	1,665
Servicing income	442	382	1,288	1,210
Gain on sale of SBA loans	429	643	707	643
Loss on sale of other loans	(887)		(887)	
Increase in cash surrender value of life insurance	428	420	1,249	1,248
Other	288	348	777	808

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Total noninterest income	2,728	2,350	6,290	5,574
Noninterest expense:				
Salaries and employee benefits	5,272	5,730	16,645	17,831
Occupancy and equipment	1,081	1,005	3,023	2,893
Writedown of loans held-for-sale	1,080		1,080	
FDIC deposit insurance premiums	849	598	3,059	2,490
Professional fees	780	691	3,202	2,833
Software subscription	261	203	747	616
Insurance expense	241	203	765	393
Low income housing investment losses	214	217	572	642
Data processing	188	196	619	686
Other real estate owned expense	49	60	537	229
Impairment of goodwill			43,181	
Other	1,233	1,841	4,568	5,572
Total noninterest expense	11,248	10,744	77,998	34,185
Income (loss) before income taxes	253	(3,900)	(63,834)	(22,401)
Income tax benefit	(398)	(1,824)	(6,272)	(10,990)
Net income (loss)	\$ 651	\$ (2,076)	\$ (57,562)	\$ (11,411)
Dividends and discount accretion on preferred stock	(193)	(599)	(1,792)	(1,776)
Net income (loss) allocable to common shareholders	\$ 458	\$ (2,675)	\$ (59,354)	\$ (13,187)
Income (loss) per common share:				
Basic	\$ 0.01	\$ (0.23)	\$ (4.70)	\$ (1.12)
Diluted	\$ 0.01	\$ (0.23)	\$ (4.70)	\$ (1.12)

See notes to consolidated financial statements

Table of Contents**Heritage Commerce Corp****Consolidated Statements of Changes in Shareholders' Equity (Unaudited)****Nine Months Ended September 30, 2010 and 2009**

	Preferred Stock			Common Stock		Retained Earnings/ (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Shareholder Equity	Comprehensive Loss
	Shares	Amount	Discount	Shares	Amount				
(Dollars in thousands, except share data)									
Balance, January 1, 2009	40,000	\$ 39,846	\$ (1,946)	11,820,509	\$ 78,854	\$ 70,986	\$ (3,473)	\$ 184,267	
Net loss						(11,411)		(11,411)	\$ (11,411)
Net change in unrealized gain on securities available-for-sale and interest-only strips, net of deferred income taxes							593	593	593
Net increase in pension and other postretirement obligations, net of deferred income taxes							697	697	697
Total comprehensive loss									\$ (10,121)
Amortization of restricted stock awards					115			115	
Cash dividends accrued on Series A preferred stock						(1,517)		(1,517)	
Accretion of discount on Series A preferred stock			259			(259)			
Cash dividend declared on common stock, \$0.02 per share						(236)		(236)	
Stock option expense					985			985	
Income tax effect of restricted stock award vesting					(70)			(70)	
Balance, September 30, 2009	40,000	\$ 39,846	\$ (1,687)	11,820,509	\$ 79,884	\$ 57,563	\$ (2,183)	\$ 173,423	
Balance, January 1, 2010	40,000	\$ 39,846	\$ (1,598)	11,820,509	\$ 80,222	\$ 56,389	\$ (2,554)	\$ 172,305	
Net loss						(57,562)		(57,562)	\$ (57,562)
Net change in unrealized gain on securities available-for-sale and interest-only strips, net of deferred income taxes							1,026	1,026	1,026
Net increase in pension and other							202	202	202

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postretirement
obligations, net of
deferred income taxes

Total comprehensive loss									\$ (56,334)
Issuance of Series B mandatorily convertible cumulative perpetual preferred stock, net of issuance costs	53,996	50,228							50,228
Conversion of Series B mandatorily convertible cumulative perpetual preferred stock into common stock	(53,996)	(50,228)		14,398,992	50,228				
Issuance of Series C convertible perpetual preferred stock, net of issuance costs	21,004	19,538							19,538
Issuance of restricted stock awards				13,500					
Amortization of restricted stock awards					117				117
Cash dividends accrued on Series A preferred stock						(1,516)			(1,516)
Accretion of unearned discount on Series A preferred stock			276			(276)			
Stock option expense					837				837
Income tax effect of restricted stock award vesting						(75)			(75)
Balance, September 30, 2010	61,004	\$ 59,384	\$ (1,322)	26,233,001	\$ 131,329	\$ (2,965)	\$ (1,326)	\$	185,100

See notes to consolidated financial statements

Table of Contents**Heritage Commerce Corp****Consolidated Statements of Cash Flows (Unaudited)**

	Nine Months Ended	
	September 30,	
	2010	2009
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (57,562)	\$ (11,411)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	600	604
Gain on sale of securities available-for-sale	(1,492)	
Provision for loan losses	25,754	28,253
Stock option expense	837	985
Amortization of other intangible assets	431	481
Amortization of restricted stock awards	117	115
Amortization (accretion) of discounts and premiums on securities	(1,295)	(324)
Writedowns and (gains) losses on sale of foreclosed assets, net	546	(106)
Gain on sale of SBA loans	(707)	(643)
Proceeds from sale of SBA loans originated for sale	17,146	
Net change in SBA loans originated for sale	(17,458)	(15,056)
Loss on sale of other loans	887	
Writedowns on other loans held-for-sale	1,080	
Increase in cash surrender value of life insurance	(1,249)	(1,248)
Goodwill impairment	43,181	
Effect of changes in:		
Accrued interest receivable and other assets	(2,963)	(10,456)
Accrued interest payable and other liabilities	(1,234)	(1,943)
Net cash provided by (used in) operating activities	6,619	(10,749)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in loans	128,960	116,417
Net change in SBA loans previously transferred to held-for-sale	(320)	(1,140)
Proceeds from sale of SBA loans transferred to held-for-sale	1,768	15,369
Purchases of securities available-for-sale	(41,434)	(69,271)
Maturities/Paydowns/Calls of securities available-for-sale	21,164	69,822
Proceeds from sale of securities available-for-sale	27,245	8,552
Purchase of premises and equipment	(171)	(269)
Changes in Federal Home Loan Bank stock and other investments	(883)	(628)
Proceeds from sale of other loans transferred to held-for-sale	10,303	
Proceeds from sale of foreclosed assets	11,595	3,505
Changes in company owned life insurance	308	
Net cash provided by investing activities	158,535	142,357
CASH FLOWS FROM FINANCING ACTIVITIES:		