

HERITAGE COMMERCE CORP
Form 10-Q
August 07, 2015

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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 June 30, 2015

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)

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

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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 26,596,094 shares of Common Stock outstanding on July 23, 2015.

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QUARTERLY REPORT ON FORM 10-Q
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Cautionary Note Regarding Forward-Looking Statements

This Report on Form 10-Q contains various statements that may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Rule 175 promulgated thereunder, and Section 21E of the Securities Exchange Act of 1934, as amended, Rule 3b-6 promulgated thereunder and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These forward-looking statements often can be, but are not always, identified by the use of words such as "assume," "expect," "intend," "plan," "project," "believe," "estimate," "predict," "anticipate," "may," "might," "should," "could," "goal," "potential" and similar expressions. We base these forward-looking statements on our current expectations and projections about future events, our assumptions regarding these events and our knowledge of facts at the time the statements are made. These statements include statements relating to our projected growth, anticipated future financial performance, and management's long-term performance goals, as well as statements relating to the anticipated effects on results of operations and financial condition.

These forward-looking statements are subject to various risks and uncertainties that may be outside our control and our actual results could differ materially from our projected results. In addition, our past results of operations do not necessarily indicate our future results. The forward-looking statements could be affected by many factors, including but not limited to:

local, regional, and national economic conditions and events and the impact they may have on us and our customers, and our assessment of that impact on our estimates including, the allowance for loan losses;

changes in the financial performance or condition of the Company's customers, or changes in the performance or creditworthiness of our customers' suppliers or other counterparties, which could lead to decreased loan utilization rates, delinquencies, or defaults and could negatively affect our customers' ability to meet certain credit obligations;

volatility in credit and equity markets and its effect on the global economy;

changes in consumer spending, borrowings and saving habits;

competition for loans and deposits and failure to attract or retain deposits and loans;

our ability to increase market share and control expenses;

our ability to develop and promote customer acceptance of new products and services in a timely manner;

risks associated with concentrations in real estate related loans;

other-than-temporary impairment charges to our securities portfolio;

an oversupply of inventory and deterioration in values of California commercial real estate;

a prolonged slowdown in construction activity;

changes in the level of nonperforming assets and charge-offs and other credit quality measures, and their impact on the adequacy of the Company's allowance for loan losses and the Company's provision for loan losses;

the effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board;

changes in inflation, interest rates, and market liquidity which may impact interest margins and impact funding sources;

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our ability to raise capital or incur debt on reasonable terms;

regulatory limits on Heritage Bank of Commerce's ability to pay dividends to the Company;

the impact of reputational risk on such matters as business generation and retention, funding and liquidity;

the impact of cyber security attacks or other disruptions to the Company's information systems and any resulting compromise of data or disruptions in service;

the effect and uncertain impact on the Company of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the rules and regulations promulgated by supervisory and oversight agencies implementing the new legislation;

significant changes in applicable laws and regulations, including those concerning taxes, banking and securities;

changes in the competitive environment among financial or bank holding companies and other financial service providers;

the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;

the costs and effects of legal and regulatory developments, including resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations or reviews;

the successful completion of the Focus Business Bank merger, integration of the business, employees and operations of Focus Business Bank with the Company and our ability to achieve the projected synergies of this acquisition; and

our success in managing the risks involved in the foregoing factors.

We are not able to predict all the factors that may affect future results. You should not place undue reliance on any forward looking statement, which speaks only as of the date of this Report on Form 10-K. Except as required by applicable laws or regulations, we do not undertake any obligation to update or revise any forward looking statement, whether as a result of new information, future events or otherwise.

Table of Contents**Part I FINANCIAL INFORMATION****ITEM 1 CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

HERITAGE COMMERCE CORP
CONSOLIDATED BALANCE SHEETS (Unaudited)

	June 30, 2015	December 31, 2014
	(Dollars in thousands)	
Assets		
Cash and due from banks	\$ 36,960	\$ 23,256
Interest-bearing deposits in other financial institutions	94,308	99,147
Total cash and cash equivalents	131,268	122,403
Securities available-for-sale, at fair value	209,092	206,335
Securities held-to-maturity, at amortized cost (fair value of \$96,808 at June 30, 2015 and \$94,953 at December 31, 2014)	100,321	95,362
Loans held-for-sale SBA, at lower of cost or fair value, including deferred costs	3,794	1,172
Loans, net of deferred fees	1,133,603	1,088,643
Allowance for loan losses	(18,757)	(18,379)
Loans, net	1,114,846	1,070,264
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	10,623	10,598
Company owned life insurance	52,053	51,257
Premises and equipment, net	7,249	7,451
Goodwill	13,055	13,044
Other intangible assets	2,898	3,276
Accrued interest receivable and other assets	35,007	35,941
Total assets	\$ 1,680,206	\$ 1,617,103
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand, noninterest-bearing	\$ 574,210	\$ 517,662
Demand, interest-bearing	235,922	225,821
Savings and money market	380,398	384,644
Time deposits-under \$250	55,571	57,443
Time deposits-\$250 and over	160,106	163,452
Time deposits-brokered	26,139	28,116
CDARS money market and time deposits	14,791	11,248
Total deposits	1,447,137	1,388,386
Accrued interest payable and other liabilities	46,030	44,359
Total liabilities	1,493,167	1,432,745
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized		
Series C convertible perpetual preferred stock, 21,004 shares issued and outstanding at June 30, 2015 and December 31, 2014 (liquidation preference of \$21,004 at June 30, 2015 and December 31, 2014)	19,519	19,519

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Common stock, no par value; 60,000,000 shares authorized; 26,596,094 shares issued and outstanding at June 30, 2015 and 26,503,505 shares issued and outstanding at December 31, 2014	134,307	133,676
Retained earnings	36,484	33,014
Accumulated other comprehensive loss	(3,271)	(1,851)
Total shareholders' equity	187,039	184,358
Total liabilities and shareholders' equity	\$ 1,680,206	\$ 1,617,103

See notes to unaudited consolidated financial statements

Table of Contents**HERITAGE COMMERCE CORP****CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
(Dollars in thousands, except per share data)				
Interest income:				
Loans, including fees	\$ 15,643	\$ 11,617	\$ 30,647	\$ 22,756
Securities, taxable	1,937	2,047	3,716	4,217
Securities, non-taxable	515	506	1,021	1,012
Interest-bearing deposits in other financial institutions	80	22	157	62
Total interest income	18,175	14,192	35,541	28,047
Interest expense:				
Deposits	533	506	1,041	1,027
Short-term borrowings		1		1
Total interest expense	533	507	1,041	1,028
Net interest income before provision for loan losses	17,642	13,685	34,500	27,019
Provision (credit) for loan losses	22	(198)	(38)	(208)
Net interest income after provision for loan losses	17,620	13,883	34,538	27,227
Noninterest income:				
Service charges and fees on deposit accounts	715	646	1,338	1,266
Increase in cash surrender value of life insurance	396	397	796	795
Servicing income	299	313	605	661
Gain on sales of SBA loans	186	442	393	599
Gain on sales of securities				50
Other	568	249	958	693
Total noninterest income	2,164	2,047	4,090	4,064
Noninterest expense:				
Salaries and employee benefits	7,712	6,819	15,754	13,062
Occupancy and equipment	1,045	987	2,090	1,932
Acquisition and integration related costs	439		577	
Insurance expense	291	269	582	538
Software subscriptions	264	191	591	438
Correspondent bank charges	259	183	495	365
Professional fees	239	126	333	712
FDIC deposit insurance premiums	238	220	476	454
Data processing	236	273	539	502
Advertising and promotion	216	269	427	418
Foreclosed assets	(36)		(206)	(19)
Other	1,714	1,432	3,235	2,913
Total noninterest expense	12,617	10,769	24,893	21,315
Income before income taxes	7,167	5,161	13,735	9,976
Income tax expense	2,690	1,837	5,120	3,576

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Net income	4,477	3,324	8,615	6,400
Dividends on preferred stock	(448)	(224)	(896)	(448)

Net income available to common shareholders	\$	4,029	\$	3,100	\$	7,719	\$	5,952
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Earnings per common share:

Basic	\$	0.14	\$	0.10	\$	0.27	\$	0.20
Diluted	\$	0.14	\$	0.10	\$	0.27	\$	0.20

See notes to unaudited consolidated financial statements

Table of Contents**HERITAGE COMMERCE CORP****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)**

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Net income	\$ 4,477	\$ 3,324	\$ 8,615	\$ 6,400
Other comprehensive income (loss):				
Change in net unrealized holding gains on available-for-sale securities and I/O strips	(3,404)	4,133	(2,516)	6,883
Deferred income taxes	1,430	(1,736)	1,056	(2,891)
Change in net unamortized unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	(14)	(13)	(28)	(27)
Deferred income taxes	6	5	12	11
Reclassification adjustment for gains realized in income				(50)
Deferred income taxes				21
Change in unrealized gains on securities and I/O strips, net of deferred income taxes	(1,982)	2,389	(1,476)	3,947
Change in net pension and other benefit plan liabilities adjustment	48	(9)	96	(18)
Deferred income taxes	(20)	4	(40)	8
Change in pension and other benefit plan liabilities net of deferred income taxes	28	(5)	56	(10)
Other comprehensive income	(1,954)	2,384	(1,420)	3,937
Total comprehensive income	\$ 2,523	\$ 5,708	\$ 7,195	\$ 10,337

See notes to unaudited consolidated financial statements

Table of Contents**HERITAGE COMMERCE CORP****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)**

Six Months Ended June 30, 2015 and 2014

	Preferred Stock		Common Stock		Retained	Accumulated Other Comprehensive	Total
	Shares	Amount	Shares	Amount	Earnings	Income / (Loss)	Shareholders' Equity
(Dollars in thousands, except share data)							
Balance, January 1, 2014	21,004	\$ 19,519	26,350,938	\$ 132,561	\$ 25,345	\$ (4,029)	\$ 173,396
Net income					6,400		6,400
Other comprehensive income						3,937	3,937
Issuance of restricted stock awards, net			15,000				
Amortization of restricted stock awards, net of forfeitures and taxes				(91)			(91)
Cash dividend declared \$0.08 per share					(2,558)		(2,558)
Stock option expense, net of forfeitures and taxes				422			422
Stock options exercised			4,572	19			19
Balance, June 30, 2014	21,004	\$ 19,519	26,370,510	\$ 132,911	\$ 29,187	\$ (92)	\$ 181,525
Balance, January 1, 2015	21,004	\$ 19,519	26,503,505	\$ 133,676	\$ 33,014	\$ (1,851)	\$ 184,358
Net income					8,615		8,615
Other comprehensive loss						(1,420)	(1,420)
Issuance of restricted stock awards, net			68,855				
Amortization of restricted stock awards, net of forfeitures and taxes				34			34
Cash dividend declared \$0.16 per share					(5,145)		(5,145)
Stock option expense, net of forfeitures and taxes				475			475
Stock options exercised			23,734	122			122
Balance, June 30, 2015	21,004	\$ 19,519	26,596,094	\$ 134,307	\$ 36,484	\$ (3,271)	\$ 187,039

See notes to unaudited consolidated financial statements

Table of Contents**HERITAGE COMMERCE CORP****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

	Six Months Ended June 30,	
	2015	2014
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 8,615	\$ 6,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of discounts and premiums on securities	662	538
Gain on sales of securities available-for-sale		(50)
Gain on sales of SBA loans	(393)	(599)
Originations of SBA loans held-for-sale	4,767	11,331
Net change in SBA loans originated for sale	(6,996)	(9,853)
Credit provision for loan losses	(38)	(208)
Increase in cash surrender value of life insurance	(796)	(795)
Depreciation and amortization	366	353
Gain on sale of foreclosed assets, net	(106)	
Amortization of intangible assets	378	230
Stock option expense, net	475	422
Amortization of restricted stock awards, net	34	(91)
Gain on proceeds of company owned life insurance		(51)
Effect of changes in:		
Accrued interest receivable and other assets	(831)	1,564
Accrued interest payable and other liabilities	1,051	184
Net cash provided by operating activities	7,188	9,375
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of securities available-for-sale	(19,953)	(34,775)
Purchase of securities held-to-maturity	(6,153)	(2,347)
Maturities/paydowns/calls of securities available-for-sale	14,195	9,859
Maturities/paydowns/calls of securities held-to-maturity	1,786	1,217
Proceeds from sale of securities available-for-sale		50,011
Net change in loans	(43,308)	(75,792)
Change in Federal Home Loan Bank and Federal Reserve Bank stock	(25)	121
Purchase of premises and equipment	(164)	(350)
Proceeds from sale of foreclosed assets	1,571	
Proceeds from company owned life insurance		406
Net cash used in investing activities	(52,051)	(51,650)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in deposits	58,751	(18,373)
Payment of cash dividends	(5,145)	(2,558)
Exercise of stock options	122	19
Net cash provided by (used in) financing activities	53,728	(20,912)
Net decrease in cash and cash equivalents	8,865	(63,187)
Cash and cash equivalents, beginning of period	122,403	112,605
Cash and cash equivalents, end of period	\$ 131,268	\$ 49,418
Supplemental disclosures of cash flow information:		
Interest paid	\$ 1,057	\$ 1,039

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Income taxes paid	3,860	2,060
Due to broker for securities purchased, settling after quarter-end	730	
Supplemental schedule of non-cash investing activity:		
Loans transferred to foreclosed assets	1,236	

See notes to unaudited consolidated financial statements

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HERITAGE COMMERCE CORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2015

(Unaudited)

1) Basis of Presentation

The unaudited consolidated financial statements of Heritage Commerce Corp (the "Company" or "HCC") and its wholly owned subsidiary, Heritage Bank of Commerce (the "Bank" or "HBC"), have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain information and notes required by accounting principles generally accepted in the United States of America ("GAAP") for annual financial statements are not included herein. The interim statements should be read in conjunction with the consolidated financial statements and notes that were included in the Company's Form 10-K for the year ended December 31, 2014.

The Company acquired BVF/CSNK Acquisition Corp., a Delaware corporation ("BVF/CSNK") on November 1, 2014, the parent company of CSNK Working Capital Finance Corp. dba Bay View Funding ("BVF"). BVF/CSNK was subsequently merged into BVF and BVF became a wholly owned subsidiary of HBC. BVF's results of operations have been included in the Company's results of operations beginning November 1, 2014.

HBC is a commercial bank serving customers located in Santa Clara, Alameda, Contra Costa, and San Benito counties of California. BVF provides business-essential working capital factoring financing to various industries throughout the United States. No customer accounts for more than 10 percent of revenue for HBC or the Company. With the acquisition of Bay View Funding, the Company now has two reportable segments consisting of Banking and Factoring. The Company's Chief Executive Officer uses segments results to make operating and strategic decisions.

In management's opinion, all adjustments necessary for a fair presentation of these consolidated financial statements have been included and are of a normal and recurring nature. All intercompany transactions and balances have been eliminated.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from these estimates.

The results for the three and six months ended June 30, 2015 are not necessarily indicative of the results expected for any subsequent period or for the entire year ending December 31, 2015.

Reclassifications

Certain reclassifications of prior year balances have been made to conform to the current year presentation. These reclassifications had no impact on the Company's consolidated financial position, results of operations or net change in cash and cash equivalents.

Adoption of New Accounting Standards

In January 2014, the Financial Accounting Standards Board ("FASB") amended existing guidance clarifying that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon

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HERITAGE COMMERCE CORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2015

(Unaudited)

1) Basis of Presentation (Continued)

completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities other than public business entities, the amendments in this update are effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. The Company has adopted the new guidance and it does not have a material impact on the consolidated financial statements.

In January 2014, the FASB issued guidance for accounting for investments in qualified affordable housing projects, which represents a consensus of the Emerging Issues Task Force and sets forth new accounting for qualifying investments in flow through limited liability entities that invest in affordable housing projects. The new guidance allows a limited liability investor that meets certain conditions to amortize the cost of its investment in proportion to the tax credits and other tax benefits it receives. The new accounting method, referred to as the proportional amortization method, allows amortization of the tax credit investment to be reflected along with the primary benefits, the tax credits and other tax benefits, on a net basis in the income statement within the income tax expense (benefit) line. For public business entities, the guidance is effective for interim and annual periods beginning after December 15, 2014. If elected, the proportional amortization method is required to be applied retrospectively. Early adoption is permitted in the annual period for which financial statements have not been issued.

The Company adopted the proportional amortization method of accounting for its low income housing investments in the third quarter of 2014. The Company quantified the impact of adopting the proportional amortization method compared to the equity method to its current year and prior period financial statements. The Company determined that the adoption of the proportional amortization method did not have a material impact to its financial statements. The low income housing investment losses, net of the tax benefits received, are included in income tax expense for all periods reflected on the consolidated income statements. See *Note 7 Income Taxes* for more information on the adoption of the proportional method of accounting for low income housing investments.

In May 2014, the FASB issued an update to the guidance for accounting for revenue from contracts with customers. The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and

Table of Contents**HERITAGE COMMERCE CORP****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****June 30, 2015****(Unaudited)****1) Basis of Presentation (Continued)**

uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. We are evaluating the impact of adopting the new guidance on the consolidated financial statements.

2) Earnings Per Share

Basic earnings per common share is computed by dividing net income, less dividends and discount accretion on preferred stock, by the weighted average common shares outstanding. The Series C Preferred Stock participates in the earnings of the Company and, therefore, the shares issued on the conversion of the Series C Preferred Stock are considered outstanding under the two class method of computing basic earnings per common share during periods of earnings. Diluted earnings per share reflect potential dilution from outstanding stock options using the treasury stock method. A reconciliation of these factors used in computing basic and diluted earnings per common share is as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(Dollars in thousands, except per share amounts)			
Net income available to common shareholders	\$ 4,029	\$ 3,100	\$ 7,719	\$ 5,952
Less: undistributed earnings allocated to Series C Preferred Stock	(331)	(358)	(605)	(673)
Distributed and undistributed earnings allocated to common shareholders	\$ 3,698	\$ 2,742	\$ 7,114	\$ 5,279
Weighted average common shares outstanding for basic earnings per common share	26,573,909	26,370,510	26,541,816	26,365,167
Dilutive effect of stock options outstanding, using the the treasury stock method	193,346	132,891	182,444	128,299
Shares used in computing diluted earnings per common share	26,767,255	26,503,401	26,724,260	26,493,466
Basic earnings per share	\$ 0.14	\$ 0.10	\$ 0.27	\$ 0.20
Diluted earnings per share	\$ 0.14	\$ 0.10	\$ 0.27	\$ 0.20

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HERITAGE COMMERCE CORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2015

(Unaudited)

3) Accumulated Other Comprehensive Income (Loss) ("AOCI")

The following table reflects the changes in AOCI by component for the periods indicated:

	For the Three Months Ended June 30, 2015 and 2014			
	Unrealized Gains (Losses) on Available- for-Sale Securities and I/O Strips(1)	Unamortized Unrealized Gain on Available- for-Sale Securities Reclassified to Held-to- Maturity(1)	Defined Benefit Pension Plan Items(1)	Total(1)
(Dollars in thousands)				
Beginning balance April 1, 2015, net of taxes	\$ 4,180	\$ 427	\$ (5,924)	\$ (1,317)
Other comprehensive income (loss) before reclassification, net of taxes	(1,974)		(2)	(1,976)
Amounts reclassified from other comprehensive income (loss), net of taxes		(8)	30	22
Net current period other comprehensive income (loss), net of taxes	(1,974)	(8)	28	(1,954)
Ending balance June 30, 2015, net of taxes	\$ 2,206	\$ 419	\$ (5,896)	\$ (3,271)
Beginning balance April 1, 2014, net of taxes	\$ 1,136	\$ 458	\$ (4,070)	\$ (2,476)
Other comprehensive income (loss) before reclassification, net of taxes	2,397		(10)	2,387
Amounts reclassified from other comprehensive income (loss), net of taxes		(8)	5	(3)
Net current period other comprehensive income (loss), net of taxes	2,397	(8)	(5)	2,384
Ending balance June 30, 2014, net of taxes	\$ 3,533	\$ 450	\$ (4,075)	\$ (92)

(1)

Amounts in parenthesis indicate debits.

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HERITAGE COMMERCE CORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2015

(Unaudited)

3) Accumulated Other Comprehensive Income (Loss) ("AOCI") (Continued)

	For the Six Months Ended June 30, 2015 and 2014			
	Unrealized Gains (Losses) on Available- for-Sale Securities and I/O Strips(1)	Unamortized Unrealized Gain on Available- for-Sale Securities Reclassified to Held-to- Maturity(1)	Defined Benefit Pension Plan Items(1)	Total(1)
(Dollars in thousands)				
Beginning balance January 1, 2015, net of taxes	\$ 3,666	\$ 435	\$ (5,952)	\$ (1,851)
Other comprehensive income (loss) before reclassification, net of taxes	(1,460)		(23)	(1,483)
Amounts reclassified from other comprehensive income (loss), net of taxes		(16)	79	63
Net current period other comprehensive income (loss), net of taxes	(1,460)	(16)	56	(1,420)
Ending balance June 30, 2015, net of taxes	\$ 2,206	\$ 419	\$ (5,896)	\$ (3,271)
Beginning balance January 1, 2014, net of taxes	\$ (430)	\$ 466	\$ (4,065)	\$ (4,029)
Other comprehensive (loss) before reclassification, net of taxes	3,992		(20)	3,972
Amounts reclassified from other comprehensive income (loss), net of taxes	(29)	(16)	10	(35)
Net current period other comprehensive income (loss), net of taxes	3,963	(16)	(10)	3,937
Ending balance June 30, 2014, net of taxes	\$ 3,533	\$ 450	\$ (4,075)	\$ (92)

(1)

Amounts in parenthesis indicate debits.

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HERITAGE COMMERCE CORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2015

(Unaudited)

3) Accumulated Other Comprehensive Income (Loss) ("AOCI") (Continued)

Details About AOCI Components	Amounts Reclassified from AOCI(1) For the Three Months Ended June 30,		Affected Line Item Where Net Income is Presented
	2015	2014	
	(Dollars in thousands)		
Unrealized gains on available-for-sale securities and I/O strips	\$	\$	Realized gains on sale of securities Income tax expense
			Net of tax
Amortization of unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	14 (6)	13 (5)	Interest income on taxable securities Income tax expense
	8	8	Net of tax
Amortization of defined benefit pension plan items			
Prior transition obligation	44	26	
Actuarial losses	(96)	(35)	
	(52)	(9)	Salaries and employee benefits
	22	4	Income tax expense
	(30)	(5)	Net of tax
Total reclassification for the period	\$ (22)	\$ 3	

(1) Amounts in parenthesis indicate debits.

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HERITAGE COMMERCE CORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2015

(Unaudited)

3) Accumulated Other Comprehensive Income (Loss) ("AOCI") (Continued)

Details About AOCI Components	Amounts Reclassified from AOCI(1) For the Six Months Ended June 30,		Affected Line Item Where Net Income is Presented
	2015	2014	
	(Dollars in thousands)		
Unrealized gains on available-for-sale securities and I/O strips	\$	\$ 50	Realized gains on sale of securities
		(21)	Income tax expense
		29	Net of tax