

HERITAGE COMMERCE CORP
Form 8-K
October 27, 2004

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

FORM 8-K

**Current Report
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

Date of report (Date of earliest event reported): October 26, 2004

Heritage Commerce Corp

(Exact name of registrant as specified in its charter)

California

(State of Incorporation)

000-23877

(Commission File Number)

77-0469558

(I.R.S. Employer Identification Number)

**150 Almaden Boulevard
San Jose, California 95113**

(Address of principal executive offices including zip code)

(408) 947-6900

(Registrant's telephone number, including area code)

Not Applicable

(Former name or former Address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

[] Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02 Results of operation and financial condition

On October 26, 2004, Heritage Commerce Corp issued a press release announcing preliminary results for the quarter ended September 30, 2004. A copy of the press release is attached as Exhibit 99.1 to this Current Report and is incorporated herein by reference.

Item 9.01 Financial statements and exhibits.

(C) Exhibits.

99.1 Press Release, dated October 26, 2004, entitled "Heritage Commerce Corp Earnings Increase 49% in Third Quarter 2004"

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: October 26, 2004

Heritage Commerce Corp

By: /s/ Lawrence D. McGovern

Name: Lawrence D. McGovern

Executive Vice President and Chief Financial Officer

By: /s/ William Del Biaggio, Jr.

William Del Biaggio, Jr.

Interim Chief Executive Officer

Index to Exhibits

<u>Exhibit No.</u>	<u>Description</u>
99.1	Press Release, dated October 26, 2004, entitled "Heritage Commerce Corp Earnings Increase 49% in Third Quarter 2004 "

Exhibit 99.1

Heritage Commerce Corp Earnings Increase 49% in Third Quarter 2004

San Jose, CA -October 26, 2004 - **Heritage Commerce Corp (Nasdaq: HTBK)**, parent company of Heritage Bank of Commerce, today reported consolidated operating results for the third quarter of 2004. Consolidated net income was \$2,888,000, or \$0.24 per diluted share, compared to \$1,940,000, or \$0.17 per diluted share, for the third quarter of 2003, a 49% increase in net income. For the nine months ended September 30, 2004, the Company earned \$5,695,000, or \$0.48 per diluted share, compared to \$5,740,000, or \$0.50 per diluted share for the same period in 2003.

The annualized returns on average assets and average equity for the third quarter of 2004 were 1.05% and 12.19%, respectively, compared with returns of 0.78% and 8.80%, respectively, for the third quarter of 2003. Annualized returns on average assets and average equity for the nine months ended September 30, 2004 were 0.73% and 8.20%, respectively, compared with returns of 0.81% and 8.95%, for the nine months ended September 30, 2003.

Financial Highlights

(third quarter 2004 versus third quarter 2003):

- Commercial loans increased 17% to \$314 million, or 43% of gross loans.
- Nonperforming assets to total assets improved to 0.24% from 0.77%.
- Net interest income increased 21% to \$11.1 million.
- Servicing income rose 33% to \$0.6 million.
- Net interest margin expanded 41 basis points to 4.42%.
- The efficiency ratio improved 554 basis points to 65.79%.
- Core deposits, excluding time deposits \$100,000 and over, grew 10% to \$794 million.

Operating Results

Net interest income increased 21% to \$11.15 million in the third quarter of 2004, compared to \$9.19 million in the third quarter of 2003, primarily the result of an 11% increase in average earning assets and increases in key market interest rates since June 30, 2004. During the third quarter of 2004, there were three increases totaling 75 basis points in the target interest rate for Federal funds sold set by the Federal Open Market Committee (FOMC) and the prime rate of interest, which is the index for the pricing on most of the Company's loan portfolio. Year-to-date net interest income increased 11% to \$31.34 million in 2004 from \$28.18 million in 2003. The net interest margin was 4.42% in

the third quarter and 4.36% for the nine months ended September 30, 2004 compared to 4.01% and 4.33% in the same period of 2003.

In the third quarter of 2004, noninterest income was \$2.36 million compared to \$2.46 million in the year-ago quarter. During the third quarter of 2004 compared to the same quarter in 2003, the gain on sale of Small Business Administration (SBA) loans increased 64% and loan-servicing income increased 33%. The Company has an ongoing program of originating SBA loans and selling the government guaranteed portion in the secondary market, while retaining the servicing of the whole loans. At September 30, 2004, Heritage Bank of Commerce was the third largest SBA lender in Northern California and eighth largest in California, based on dollar volume of loans originated.

Partially offsetting the increased income from SBA lending was a \$191,000 reduction in mortgage brokerage fees resulting from the close of the Company's residential mortgage department in June 2004. In addition to the drop in mortgage brokerage fees, other noninterest income, primarily related to the reclassification of lease income to interest income and principal payment, was down \$264,000 compared to the same quarter in 2003 and there were relatively minor decreases in service charges and the appreciation of corporate owned life insurance. There were no securities gains recognized in the third quarter of 2004, compared to \$74,000 in gains recognized in the third quarter of 2003.

For the nine months ended September 30, 2004, noninterest income dropped 10% to \$7.14 million from \$7.94 million in same period of 2003. Gain on sale of loans increased 34%, servicing income rose 26%, service charges and other fees on deposit accounts grew 4%. Offsetting these increases, mortgage brokerage fees were down 80%, or \$683,000, because of lower mortgage originations and other income was off 73%, or \$946,000, primarily related to the reclassification of lease income to interest income and principal payment.

Operating expenses were \$8.89 million for the third quarter of 2004 compared to \$8.31 million for the year-ago quarter. In the nine months ended September 30, 2004, operating expenses totaled \$28.52 million compared to \$25.30 million in the nine months ended September 30, 2003. The efficiency ratio was 65.79% in the third quarter of 2004 and 74.11% year-to-date. In 2003, the efficiency ratio was 71.33% in the third quarter and 70.02% year-to-date.

During the second quarter of 2004, the Company made several changes to reduce operating expenses and improve efficiency. The cost of these changes, primarily severance payments related to the elimination and replacement of certain positions, resulted in pre-tax charges of approximately \$2.05 million in the quarter ended June 30, 2004. Savings related to the changes of approximately \$350,000 per quarter before taxes are reflected in the third quarter 2004 salary and employee benefit expense. Offsetting the savings in salary and employee benefits are increases in other noninterest expense including professional fees of \$332,000, data processing expense of \$144,000, and retirement plan expense of \$342,000.

Balance Sheet, Capital Management and Credit Quality

At September 30, 2004, total assets increased 10% to \$1.08 billion from \$985 million at September 30, 2003. In the third quarter, total deposits grew 8% to \$903 million from \$836 million in the prior year. More importantly, core deposits, the lowest-cost funding source for the Company, increased 10% to \$794 million.

Total loans were \$728 million at September 30, 2004, a 13% increase over the same period in 2003. Real estate mortgage loans, primarily secured by first mortgages on commercial property, were \$301 million at September 30, 2004, a 19% increase over the same period in 2003. Commercial loans grew to \$314 million at the end of the third quarter of 2004, a 17% increase over the same period in 2003. At September 30, 2004, real estate mortgage loans and commercial loans represented 41% and 43%, respectively, of total loans. Real estate construction loans at the end of the third quarter of 2004 were \$106 million, or 15% of total loans, down 9% from the same period a year ago. Although construction loans outstanding are down from September 30, 2003, unfunded construction loan commitments have increased to \$75 million from \$56 million, reflecting increased activity in this segment of the loan portfolio from September 30, 2003.

Credit quality, as reflected by the level of nonperforming assets, remained stable at September 30, 2004, with nonperforming assets (NPA) at \$2.64 million, or 0.24% of total assets, compared to \$2.63 million, or 0.24% of total assets, at June 30, 2004. Credit quality was improved compared to September 30, 2003, when NPA were \$7.54 million, or 0.77% of total assets. The allowance for loan and lease losses at September 30, 2004 was \$13.38 million, or 1.84% of total loans, and represents 507% of nonperforming loans. The allowance for loan and lease losses at September 30, 2003 was \$13.04 million, or 2.03% of loans, and represented 189.19% of nonperforming loans. Net recoveries in the third quarter of 2004 were 0.05% of average loans, compared to net charge-offs of 1.40% of average loans in the third quarter of 2003.

In June 2004, the Company's Board of Directors approved the repurchase of up to \$10 million of its common stock, representing approximately 600,000 shares at current market prices. As of September 30, the Company had purchased approximately 176,000 shares at an average price of \$14.62. Shares were purchased on the open market using available cash.

Shareholders' equity increased 10% to \$96.64 million, or \$8.29 per share, at September 30, 2004, compared to \$87.48 million, or \$7.72 per share, a year earlier. Capital ratios continue to be above the well-capitalized guidelines established by regulatory agencies. The Company's leverage ratio at September 30, 2004, was 10.72% compared to 10.99% at September 30, 2003.

Heritage Commerce Corp, a bank holding company established in February 1998, is the parent company of Heritage Bank of Commerce, established in 1994 and headquartered in San Jose with offices in Los Gatos, Fremont, Danville, Morgan Hill, Gilroy, Mountain View and two offices in Los Altos. Additionally, Heritage Capital Group, the bank's asset based lending division, has offices in San Jose and Los Angeles. Heritage Bank of Commerce is also an SBA Preferred Lender with offices in San Jose, Fresno, Santa Cruz, Elk Grove, Watsonville, Chico, Glendale, Irvine and Pittsburg, California.

Forward Looking Statement Disclaimer

This release may contain forward-looking statements that are subject to risks and uncertainties. Such risks and uncertainties may include but are not necessarily limited to fluctuations in interest rates and monetary policy established by the Federal Reserve, inflation, government regulations, general economic conditions, competition within the business areas in which the Company is conducting its operations, including the real estate market in California, the ability to recognize identified cost savings, and other factors beyond the Company's control. Such risks and uncertainties could cause results for subsequent interim periods or for the entire year to differ materially from those indicated. For a discussion of factors which could cause results to differ, please see the Company's reports on *Forms 10-K* and *10-Q* as filed with the Securities and Exchange Commission and the Company's press releases. Readers should not place undue reliance on the forward-looking statements, which reflect management's view only as of the date hereof. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.

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(in \$000's, unaudited)	2004	2004	2003
Interest Income	\$ 13,633	\$ 12,690	\$ 11,556
Interest Expense	2,484	2,298	2,369
Net Interest Income	11,149	10,392	9,187
Provision for Loan Losses	600	600	600
Net Interest Income after Loan Loss Provision	10,549	9,792	8,587
Noninterest Income:			
Gain on Sale of Loans	920	639	561
Servicing Income	616	561	463
Service Charges and Other Fees on Deposit Accounts	415	497	480
Appreciation of Corporate Owned Life Insurance	236	234	254
Gain on Sale of Securities Available-For-Sale	0	264	74
Mortgage Brokerage Fees	19	30	210
Other	157	79	421
Total Noninterest Income	2,363	2,304	2,463
Noninterest Expense:			
Salaries & Employee Benefits	4,301	5,456	4,423
Occupancy & Equipment	1,089	1,135	1,242
Other	3,499	4,325	2,645
Total Noninterest Expense	8,889	10,916	8,310
Income Before Taxes	4,023	1,180	2,740
Provision for Income Taxes	1,135	380	800
Net Income	\$ 2,888	\$ 800	\$ 1,940

3-Month Period Ended:

PER SHARE DATA
(unaudited)

	September 30, 2004	June 30, 2004	September 30, 2003
Basic Earnings Per Share	\$ 0.25	\$ 0.07	\$ 0.17
Diluted Earnings Per Share	\$ 0.24	\$ 0.07	\$ 0.17
Weighted Average Basic Shares Outstanding	11,621,963	11,543,552	11,254,328
Weighted Average Diluted Shares Outstanding	11,998,520	11,954,572	11,696,207
Common Shares Outstanding	11,657,865	11,596,491	11,326,163
Book Value Per Share	\$ 8.29	\$ 7.83	\$ 7.72
Tangible Book Value Per Share	\$ 8.29	\$ 7.83	\$ 7.72

3-Month Period Ended:

KEY FINANCIAL RATIOS
(unaudited)

	September 30, 2004	June 30, 2004	September 30, 2003
Annualized Return on Average Equity	12.19%	3.47%	8.80%
Annualized Return on Average Assets	1.05%	0.30%	0.78%
Net Interest Margin	4.42%	4.27%	4.01%
Efficiency Ratio	65.79%	85.98%	71.33%

3-Month Period Ended:

AVERAGE BALANCES

(in \$000's, unaudited)	September 30, 2004	June 30, 2004	September 30, 2003
Average Assets	\$ 1,094,330	\$ 1,067,833	\$ 989,430
Average Earning Assets	\$ 1,003,903	\$ 979,039	\$ 908,143
Average Gross Loans & Leases	\$ 715,957	\$ 690,283	\$ 637,345

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Average Deposits	\$	917,476	\$	892,206	\$	839,679
Average Equity	\$	94,275	\$	92,641	\$	87,428

CONSOLIDATED BALANCE SHEET (in \$000's, unaudited)	End of Period:		
	September 30, 2004	June 30, 2004	September 30, 2003
ASSETS			
Cash and Due from Banks	\$ 47,347	\$ 56,404	\$ 44,906
Fed Funds Sold	5,800	13,800	51,300
Investment Securities	228,483	230,435	172,010
Loans Held For Sale	28,782	31,916	30,675
Loans:			
Real Estate-Mortgage	301,249	290,956	252,664
Real Estate-Land and Construction	106,303	111,161	117,441
Commercial Loans	314,007	298,828	268,607
Direct Financing Lease	3,538	3,578	0
Consumer Loans	2,051	1,625	2,487
Gross Loans	727,148	706,148	641,199
Deferred Loan Costs	467	709	981
Loans, Net of Deferred Costs	727,615	706,857	642,180
Allowance for Loan Losses	(13,381)	(12,688)	(13,039)
Net Loans	714,234	694,169	629,141
Premises & Equipment, Net	3,489	3,641	4,532
Accrued Interest Receivable and Other Assets	54,197	53,022	52,156
Total Assets	\$1,082,332	\$ 1,083,387	\$ 984,720
LIABILITIES & SHAREHOLDERS' EQUITY			
Liabilities:			
Deposits			
Demand Deposits-Noninterest Bearing	\$ 290,845	\$ 301,329	\$ 252,133
Demand Deposits-Interest Bearing	115,911	111,282	94,092
Savings/Money Market	349,004	364,124	334,613
Time Deposits, Under \$100	38,170	38,293	41,020
Time Deposits, \$100 and Over	108,726	104,141	114,089
Total Deposits	902,656	919,169	835,947
Other Borrowings	47,800	39,800	28,600
Notes Payable To Subsidiary Grantor Trusts	23,702	23,702	23,000
Accrued Interest Payable and Other Liabilities	11,539	9,897	9,689
Total Liabilities	985,697	992,568	897,236
Shareholders' Equity:			
Common Stock	66,235	65,655	64,561
Accumulated Other Comprehensive Loss, Net of Taxes	(271)	(2,620)	(11)
Retained Earnings	30,671	27,784	22,934
Total Shareholders' Equity	96,635	90,819	87,484
Total Liabilities & Shareholders' Equity	\$1,082,332	\$ 1,083,387	\$ 984,720

End of Period:

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CREDIT QUALITY DATA (in \$000's, unaudited)	September 30, 2004	June 30, 2004	September 30, 2003
Nonaccrual Loans	\$ 1,926	\$ 2,102	\$ 6,497
Over 90 Days Past Due and Still Accruing	711	530	395
Total Nonperforming Loans	2,637	2,632	6,892
Other Real Estate Owned	0	0	652
Total Nonperforming Assets	\$ 2,637	\$ 2,632	\$ 7,544
Net (Recoveries) Charge-offs	(94)	63	2,253
Net (Recoveries) Charge-offs as Percent of Average Loans	-0.05%	0.04%	1.40%
Allowance for Loan Losses to Total Loans	1.84%	1.79%	2.03%
Allowance for Loan Losses to Nonperforming Loans	507.43%	482.07%	189.19%
Nonperforming Assets to Total Assets	0.24%	0.24%	0.77%
Nonperforming Loans to Total Loans	0.36%	0.37%	1.07%

End of Period:

OTHER PERIOD-END STATISTICS (unaudited)	September 30, 2004	June 30, 2004	September 30, 2003
Shareholders Equity / Total Assets	8.93%	8.38%	8.88%
Loan to Deposit Ratio	80.61%	76.90%	76.82%
Noninterest Bearing Deposits / Total Deposits	32.22%	32.78%	30.16%
Leverage Ratio	10.72%	10.67%	10.99%