

HERITAGE COMMERCE CORP

Form 10-Q

August 04, 2017

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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, 2017

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	77 0469558
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
150 Almaden Boulevard, San Jose, California	95113
(Address of Principal Executive Offices)	(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 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, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
			Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 38,130,812 shares of Common Stock outstanding on July 27, 2017.

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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,” “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:

- current and future economic and market conditions in the United States generally or in the communities we serve, including the effects of declines in property values, high unemployment rates and overall slowdowns in economic growth should these events occur;
- 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;
- volatility in credit and equity markets and its effect on the global economy;
- changes in the competitive environment among financial or bank holding companies and other financial service providers;
- changes in consumer and business spending and saving habits and the related effect on our ability to increase assets and to attract deposits;
- 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;
- an imbalance of supply and demand or deterioration in values of California commercial real estate;
- a prolonged slowdown in construction activity;
- other than temporary impairment charges to our securities portfolio;
- 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;
- 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;

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- changes in our capital management policies, including those regarding business combinations, dividends, and share repurchases, among others;
- operational issues stemming from, and/or capital spending necessitated by, the potential need to adapt to industry changes in information technology systems, on which we are highly dependent;
- our ability to keep pace with technological changes, including our ability to identify and address cyber-security risks such as data security breaches, “denial of service” attacks, “hacking” and identity theft;
- inability of our framework to manage risks associated with our business, including operational risk and credit risk;
- risks of loss of funding of Small Business Administration or SBA loan programs, or changes in those programs;
- 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;
- effect of lower corporate tax rates if enacted on the Company’s deferred tax assets, equity, and income tax provision;
- significant changes in applicable laws and regulations, including those concerning taxes, banking and securities;
 - 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;
- 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;
- availability of and competition for acquisition opportunities;
- risks associated with merger and acquisition integration;
- risks resulting from domestic terrorism;
- risks of natural disasters and other events beyond our control; 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 Q. 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.

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Part I—FINANCIAL INFORMATION

ITEM 1—CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

HERITAGE COMMERCE CORP

CONSOLIDATED BALANCE SHEETS (Unaudited)

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Assets		
Cash and due from banks	\$ 36,223	\$ 27,993
Other investments and interest-bearing deposits in other financial institutions	229,790	238,110
Total cash and cash equivalents	266,013	266,103
Securities available-for-sale, at fair value	369,901	306,589
Securities held-to-maturity, at amortized cost (fair value of \$366,102 at June 30, 2017 and \$318,748 at December 31, 2016)	368,266	324,010
Loans held-for-sale - SBA, at lower of cost or fair value, including deferred costs	3,720	5,705
Loans, net of deferred fees	1,566,324	1,502,607
Allowance for loan losses	(19,397)	(19,089)
Loans, net	1,546,927	1,483,518
Federal Home Loan Bank and Federal Reserve Bank stock and other investments, at cost	17,299	15,196
Company-owned life insurance	59,990	59,148
Premises and equipment, net	7,595	7,490
Goodwill	45,664	45,664
Other intangible assets	6,163	6,950
Accrued interest receivable and other assets	41,362	50,507
Total assets	\$ 2,732,900	\$ 2,570,880
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand, noninterest-bearing	\$ 948,774	\$ 917,187
Demand, interest-bearing	573,699	541,282
Savings and money market	634,802	572,743
Time deposits - under \$250	54,129	57,857
Time deposits - \$250 and over	147,242	163,670
CDARS - interest-bearing demand, money market and time deposits	16,085	9,401

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Total deposits	2,374,731	2,262,140
Subordinated debt, net of issuance costs	39,119	—
Accrued interest payable and other liabilities	49,819	48,890
Total liabilities	2,463,669	2,311,030
Shareholders' equity:		
Common stock, no par value; 60,000,000 shares authorized; 38,120,263 shares issued and outstanding at June 30, 2017 and 37,941,007 shares issued and outstanding at December 31, 2016	216,788	215,237
Retained earnings	58,910	52,527
Accumulated other comprehensive loss	(6,467)	(7,914)
Total shareholders' equity	269,231	259,850
Total liabilities and shareholders' equity	\$ 2,732,900	\$ 2,570,880

See notes to unaudited consolidated financial statements

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HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Interest income:				
Loans, including fees	\$ 21,207	\$ 19,735	\$ 41,605	\$ 38,923
Securities, taxable	3,442	2,829	6,319	5,603
Securities, exempt from Federal tax	565	575	1,131	1,154
Other investments and interest-bearing deposits in other financial institutions	893	365	1,749	886
Total interest income	26,107	23,504	50,804	46,566
Interest expense:				
Deposits	946	760	1,817	1,507
Subordinated debt	228	—	228	—
Short-term borrowings	—	—	—	11
Total interest expense	1,174	760	2,045	1,518
Net interest income before provision for loan losses	24,933	22,744	48,759	45,048
Provision (credit) for loan losses	(46)	351	275	752
Net interest income after provision for loan losses	24,979	22,393	48,484	44,296
Noninterest income:				
Service charges and fees on deposit accounts	801	783	1,541	1,550
Increase in cash surrender value of life insurance	420	440	842	889
Servicing income	205	371	490	742
Gain on sales of SBA loans	164	279	488	584
Gain on proceeds from company-owned life insurance	—	1,019	—	1,019
Gain (loss) on sales of securities	—	347	(6)	527
Other	703	421	1,233	963
Total noninterest income	2,293	3,660	4,588	6,274
Noninterest expense:				
Salaries and employee benefits	9,209	8,742	18,695	17,689
Occupancy and equipment	1,216	1,081	2,284	2,157
Professional fees	673	708	1,744	1,533
Other	4,156	3,850	7,859	7,687
Total noninterest expense	15,254	14,381	30,582	29,066
Income before income taxes	12,018	11,672	22,490	21,504
Income tax expense	4,569	4,377	8,503	8,103

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Net income	7,449	7,295	13,987	13,401
Dividends on preferred stock	—	(504)	—	(1,008)
Net income available to common shareholders	7,449	6,791	13,987	12,393
Undistributed earnings allocated to Series C preferred stock	—	(576)	—	(979)
Distributed and undistributed earnings allocated to common shareholders	\$ 7,449	\$ 6,215	\$ 13,987	\$ 11,414
Earnings per common share:				
Basic	\$ 0.20	\$ 0.19	\$ 0.37	\$ 0.35
Diluted	\$ 0.19	\$ 0.19	\$ 0.36	\$ 0.35

See notes to unaudited consolidated financial statements

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HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Net income	\$ 7,449	\$ 7,295	\$ 13,987	\$ 13,401
Other comprehensive income:				
Change in net unrealized holding gains on available-for-sale securities and I/O strips securities and I/O strips	1,591	2,723	2,436	7,562
Deferred income taxes	(668)	(1,144)	(1,023)	(3,176)
Change in net unamortized unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	(13)	(76)	(26)	(90)
Deferred income taxes	6	32	11	38
Reclassification adjustment for losses (gains) realized in income	—	(347)	6	(527)
Deferred income taxes	—	146	(2)	221
Change in unrealized gains on securities and I/O strips, net of deferred income taxes	916	1,334	1,402	4,028
Change in net pension and other benefit plan liability adjustment	38	38	77	86
Deferred income taxes	(16)	(16)	(32)	(36)
Change in pension and other benefit plan liability, net of deferred income taxes	22	22	45	50
Other comprehensive income	938	1,356	1,447	4,078
Total comprehensive income	\$ 8,387	\$ 8,651	\$ 15,434	\$ 17,479

See notes to unaudited consolidated financial statements

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HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)

Six Months Ended June 30, 2017 and 2016

	Preferred Stock		Common Stock		Retained	Accumulated	Total
	Shares	Amount	Shares	Amount	Earnings	Other Comprehensive	Shareholders'
	(Dollars in thousands)					Income / (Loss)	Equity
Balance, January 1, 2016	21,004	\$ 19,519	32,113,479	\$ 193,364	\$ 38,773	\$ (6,220)	\$ 245,436
Net income	—	—	—	—	13,401	—	13,401
Other comprehensive income	—	—	—	—	—	4,078	4,078
Issuance of restricted stock awards, net	—	—	82,372	—	—	—	—
Amortization of restricted stock awards, net of forfeitures and taxes	—	—	—	296	—	—	296
Cash dividend declared \$0.18 per share	—	—	—	—	(6,803)	—	(6,803)
Stock option expense, net of forfeitures and taxes	—	—	—	482	—	—	482
Stock options exercised	—	—	98,212	623	—	—	623
Balance, June 30, 2016	21,004	\$ 19,519	32,294,063	\$ 194,765	\$ 45,371	\$ (2,142)	\$ 257,513
Balance, January 1, 2017	—	—	37,941,007	\$ 215,237	\$ 52,527	\$ (7,914)	\$ 259,850
Net income	—	—	—	—	13,987	—	—