HERITAGE COMMERCE CORP
Form DEFA14A
April 27, 2004

OMB APPROVAL
OMB Number: 3235-0059
Expires: February 28, 2006
Estimated average burden
hours per response. . . 12.75

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
SCHEDULE 14A

PROXY STATEMENT PURSUANT TO SECTION 14(A) OF THE SECURITIES
EXCHANGE ACT OF 1934 (AMENDMENT NO.)

Filed by the Registrant [X] Filed by a Party other than the Registrant [ ]
Check the appropriate box:
[ ] Preliminary Proxy Statement
[ ] CONFIDENTIAL, FOR USE OF THE COMMISSION ONLY (AS PERMITTED BY RULE 14a-6(e)(2))
[ ] Definitive Proxy Statement
[X] Definitive Additional Materials
[ ] Soliciting Material Pursuant to ss.240.14a-12

Heritage Commerce Corp

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

[X] No fee required.

[ ] Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 3) (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

PERSONS WHO POTENTIALLY ARE TO RESPOND TO THE COLLECTION OF INFORMATION CONTAINED IN THIS FORM ARE NOT REQUIRED TO RESPOND UNLESS THE FORM DISPLAYS A CURRENTLY VALID OMB CONTROL NUMBER.

[ ] Fee paid previously with preliminary materials.

[ ] Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

From: Brad Smith

Sent: Monday, April 26, 2004 12:05 PM

To: Bank Employees

Subject: Important Message

** High Priority **

I wanted to take a moment to make all Heritage Bankers aware of an issue that has surfaced recently and will surely come up to many of you in the form of questions from customers, Heritage shareholders and friends during the next few weeks.

Late Friday afternoon, a group calling themselves the "Concerned Shareholders Committee of Heritage Commerce Corp" filed documents with the SEC (Securities and Exchange) that effectively gives them the opportunity to place a proxy ballot in front of Heritage shareholders that is substantially different than the proxy that was forwarded to shareholders earlier by our own Board of Directors. Specifically, the proxy from this dissident group seeks shareholder approval to unseat two of our Directors and increase the size of the Board from its current 12 members to 13, effectively placing three of their own members on the Heritage Board. Their "platform" for pursuit of this proxy contest centers around their own perceptions regarding the following: poor financial performance; lack of strategic plan; and weak corporate governance.

I want all Heritage Bankers to know that your Board and Management vigorously oppose the proxy proposal from these dissidents and we will actively work to convince shareholders to vote the proxy forwarded to them earlier. In fact, we ask that all Heritage Bankers that are Heritage shareholders support our own proxy by voting your shares using the "white" card that has been forwarded to you. Although our opposition will be a necessary and important part of Board and Senior Management's work from now until our Annual Meeting of Shareholders scheduled for May 27th, it is absolutely imperative that we all continue "on course" with service to our customers and development of new business opportunities. We will be communicating more details on our position regarding the issues raised by the dissidents with our shareholders in the near future. We find this proxy contest to be ill-founded and uninformed and believe that our track record to date gives our entire Heritage management and staff tremendous credibility. For your review, I have attached our first quarter press release that was issued Friday afternoon and will follow with subsequent releases that may occur as we proceed forward on this proxy issue.

It is important that any questions that may be asked of you by customers, prospects and/or shareholders regarding this issue during the course of your day be directed to Rebecca Levey (494-4513). She will coordinate the response from the appropriate party. If you have any questions regarding this issue, please contact me and I will be happy to respond. Once again, it is important that we proceed with "business as usual". Please contact me if you have any questions or comments.

Brad L. Smith
Chief Executive Officer

PRESS RELEASE

HERITAGE COMMERCE CORP

FOR ADDITIONAL INFORMATION, CONTACT:

Brad Smith, CEO.......(408) 947-6900
Rebecca Levey SVP/Marketing...(408) 494-4513

For Immediate Release: April 23, 2004

HERITAGE COMMERCE CORP REPORTS 1Q04 NET INCOME OF $2.0 MILLION, OR $0.17 EPS; CORE DEPOSITS INCREASE 13% TO $776 MILLION

San Jose, CA - April 23, 2004 - Heritage Commerce Corp (the "Company") (Nasdaq: HTBK), parent company of Heritage Bank of Commerce, today reported first quarter net income increased 4%, as assets increased 12% and core deposits rose 13% boosted by a strong start for its new Los Gatos office and solid contribution from all divisions/offices. Net income was $2.0 million, or $0.17 diluted per share, compared to $1.9 million, or $0.17 diluted per share, in the first quarter ended March 31, 2003.

"The first quarter puts us well on our way to achieving our strategic plan for the year," said Brad L. Smith, CEO. "Our focus over the past decade has been to build a solid business banking franchise and quickly capture the banking business of the region's entrepreneurs. We have invested heavily in the infrastructure and talent that provides the high-level of service and breadth of products required to meet the needs of the closely-held business professional. With this infrastructure in place, we are now shifting our focus to optimize profitability and shareholder value. Frankly, we won't be satisfied until we reach performance in the top quartile of our peers, which is the overall goal of our strategic plan."

FINANCIAL HIGHLIGHTS (1Q04 versus 1Q03):

- Assets increased 12% to $1.06 billion.
- Net interest income after provision for loan losses increased 10% to $9.2 million.
- Servicing income from loans rose 19% to $505,000.
- Income from service charges and account fees increased 15% to $473,000.
- Net income increased 4% to $2.0 million, or $0.17 per diluted share.
- Core deposits, excluding time deposits $100,000 and over, grew 13% to $776 million.
- Nonperforming assets were unchanged at $4.8 million, or 0.45% of total assets.
- Commercial loans increased 7% to $276 million, or 41 % of gross loans.

ECONOMIC DEVELOPMENTS

"When we established Heritage Bank of Commerce in 1994 with $14 million in capital, we set an ambitious goal of growing assets to $1 billion within ten years. Due to the hard work and dedication of our team, we achieved that goal in 9 years, crossing the billion dollar mark in December," Smith said.

"The difficult regional economic conditions coupled with an unfavorable interest rate environment constrained loan growth and dampened profitability in the past few years. In spite of this difficult climate, we've made strong, even extraordinary, progress in building the institution," said Richard L. Conniff, COO.

"The recent positive reports on job growth and the state economic recovery are good news for us," said Smith. The Silicon Valley SAN JOSE BUSINESS JOURNAL reported in a March 26, 2004 article, "...the unemployment rate in Santa Clara County dropped to 6.8% in February from 7.1% in January. ... manufacturing employment overall showed its first increase (in February) since December 2000 . .... Employment in the information sector was up 1%. Internet, Web service and hosting employment was also up 1 %. Telecommunications jumped 1.9%."

"We are beginning to see strengthening demand for new loans, particularly for residential and small commercial construction projects," said Smith. "The SBA's decision to restore funding levels for small business owners is also a very positive sign. As one of the top ten SBA lenders in California, the temporary, yet severe, curtailment of SBA

---

150 Almaden Boulevard o San Jose, CA 95113 o (408) 947-6900 o fax (408) 947-6910

lending limits imposed during the first quarter reduced our SBA loan originations by 32% to $12.5 million from $18.3 million a year ago. Fortunately, demand in this sector appears to have been delayed rather than eliminated, and our SBA loan pipeline is very strong. In the first quarter, we opened a new SBA lending office in Irvine, expanding our business lending presence in Southern California."

ACCOMPLISHMENTS REVIEW

In its first decade of operations, Heritage Commerce Corp has generated strong growth. The following highlights a few of the accomplishments of the past six years:

- Net income's compounded average growth rate (CAGR) was 18% from 1997 to 2003.
- Earnings per share have grown at a CAGR of 14% since 1997.
- Assets grew at a CAGR of 17% in the past six years.
- Deposits posted a CAGR of 15% from 1997 to 2003.
- The loan portfolio showed a CAGR of 22% in the past six years.
- Asset quality has remained well above that of similar sized banks, both in California and nationwide.
  - Nonperforming loans to total loans are well below peers.
  - Loan loss reserves to total loans continue to be well above the peer average.

FIRST QUARTER OPERATING RESULTS

Net interest income totaled $9.8 million in 1 Q04 compared to $9.7 million in 1 Q03. A 21 % decrease in interest expense offset a 4% decrease in interest income. Net interest margin was 4.38% and has been gradually improving over the last few quarters, up 4 basis points from 4Q03 and 37 basis points higher than the all-time low of 4.01% reported in 3Q03. "We have positioned our portfolio to benefit from rising interest rates, in anticipation of improving economic activity and the likely associated change in Fed monetary policy," said Richard Conniff, Chief Operating Officer. "It appears that an upturn in rates is approaching, and the margin compression we've experienced in the past three years will stabilize and margins may begin to expand."

First quarter 2004 noninterest income dropped 17% to $2.5 million from $3.0 million in the first quarter of the previous year. Gain on sale of SBA loans increased 31 %, loan servicing income increased 19%, and service charges and other fees grew 15% in the first quarter of 2004 compared to the like period a year ago. Offsetting these gains were lower gain on sale of securities, which decreased $213,000 and a $244,000 drop in residential mortgage loan brokering fees. "We also reclassified an equipment lease into a direct financing lease, which is now included in loans. As a result, the payment amounts are now recorded as principle and interest payments rather than noninterest income and expenses," Conniff explained.

Operating expenses were $8.7 million for the first quarter of 2004, a 2% increase from the year-ago quarter, and a 4% decline from the preceding quarter. "With our branch footprint now established, earnings optimization, cost containment and productivity improvement are now our focus. We invested heavily in the last two quarters in a new outsourced data processing platform and anticipate savings of approximately $200,000 pre-tax per year, going forward," said Larry McGovern, CFO. "Outsourcing data processing cost $335,000 in 4Q03 and $195,000 in 1Q04. In addition, the Los Gatos branch, opened in December 2003, is now beginning to contribute to revenues. With the investment in a new technology platform complete and as our new branch begins contributing to revenues, we anticipate improvements in our efficiency ratio in the remainder of the year." Heritage Commerce Corp's efficiency ratio was 71.01% in the first quarter of 2004 compared to 73.96% in the prior quarter and 67.25% in the year ago quarter.

CAPITAL MANAGEMENT AND CREDIT QUALITY

At March 31, 2004, total assets increased 12% to $1.06 billion from $943 million at March 31, 2003. In the first quarter, total deposits grew 7% to $885 million from $825 million a year ago. More importantly, core deposits, the lowest-cost funding source for the company, increased 13% to $776 million from $688 million at the end of the first quarter of 2003. Noninterest bearing deposits grew 17% to $288 million, representing 33% of total deposits, whereas a year ago they represented 30% of total deposits. "Our entire branch team is focused on building core deposits, and I am proud of the success they produced this quarter. Our Los Gatos branch has over $11 million in deposits in its first four months of operation and is off to a splendid start," Smith noted.

Total loans grew 3% in 1Q04, with commercial real estate mortgage loans up 15% and commercial loans up 7% from the first quarter of 2003. "Our commercial real estate loans are primarily mini-perm loans, which amortize on a long-term schedule with a five to seven year renewal/refinance period. This type of loan provides affordable payments for the borrower and allows newer projects to establish an income history prior to placement of permanent financing. For the lender, mini-perm loans offer solid yields and the opportunity to review and reprice the loan at regular intervals," Smith noted.

Real estate construction loans were flat at $101 million when compared to the prior quarter, but down 28% from the same period a year ago. "Construction loans turn over relatively quickly, as projects are completed and sold or refinanced," said Smith. "Softness in the local commercial real estate market has made it more difficult to maintain that portion of the construction loan portfolio. Residential real estate, however, has not only held its value, but has also shown enormous resilience in this economic cycle. Continuing strong demand for residential housing in the face of limited supply remains a solid support for our construction lending department."

Credit quality remained strong in the first quarter with nonperforming assets (NPA) unchanged from a year ago at $4.8 million, or 0.45% of total assets, and nonperforming loans (NPL) to gross loans were 0.72% versus 0.74% for the year earlier period. Excluding SBA guarantees on the nonperforming loans, NPA/Assets was 0.42% and NPL/Gross Loans was 0.67%. The allowance for loan and lease losses was $12.2 million, or 1.81% of total loans and represents 253% of nonperforming loans, at March 31, 2004.

As reported in the Form 10-K for the fiscal year ended December 31, 2003, during the first quarter the Company identified a $4 million unsecured commercial line of credit with risks that created doubt about full repayment under the original terms of the agreement. During the first quarter of 2004, the loan was placed on nonaccrual and a specific reserve was established. Subsequent to placement on nonaccrual, the Company was advised that the borrower had filed for bankruptcy protection. Although the Company continues to negotiate with the borrower within the framework of the bankruptcy, $2.0 million was charged-off during 1Q04, and a specific reserve of $1.0 million was established for the remaining balance of $2.0 million.

Shareholders' equity increased 11 % to $93 million, or $8.12 per share at March 31, 2004, compared to $84 million, or $7.50 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 March 31, 2004, was 11.54% compared to 11.25% at March 31, 2003.

HERITAGE COMMERCE CORP, a bank holding company established in February 1998, is the parent company of Heritage BANK OF Commerce, headquartered in San Jose with an office located in Los Gatos. HERITAGE BANK OF COMMERCE is an independent full service community business bank with three divisions: Heritage BANK EAST BAY, in Fremont and Danville; Heritage BANK SOUTH Valley in Morgan Hill and Gilroy, and BANK OF LOS ALTOS, with two locations in Los Altos and one in Mountain View. 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 ranked the third largest SBA lender in Northern California, eighth in the State, and has SBA Loan Production 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, results of bankruptcy proceedings in which the Company is an unsecured creditor, 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 10-0 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.

CONSOLIDATED INCOME STATEMENT	3-Month Period Ended:		
(IN $000'S, UNAUDITED)	3/31/2004	12/31/2003	3/31/2003

Interest Income	$ 11,984	$ 12,219	$ 12,448
Interest Expense	2,189	2,309	2,773
Net Interest Income	9,795	9,910	9,675
Provision for Loan Losses	600	400	1,300
Net Interest Income after Loan Loss Provision	9,195	9,510	8,375
Noninterest Income:			
Gain on Sale of Loans	727	523	557
Servicing Income	505	480	425
Service Charges and Other Fees	473	478	411
Appreciation of Corporate Owned Life Insurance	329	260	334
Equipment Leasing	0	267	310
Gain on Sale of Securities Available-for-Sale	212	203	425
Mortgage Brokerage Fees	119	161	363
Other	109	114	139
Total Noninterest Income	2,474	2,486	2,964
Noninterest Expense:			
Salaries & Employee Benefits	4,720	4,311	4,704
Occupancy & Equipment	1,287	1,465	1,210
Other	2,705	3,268	2,586
Total Noninterest Expense	8,712	9,044	8,500
Income Before Taxes	2,957	2,952	2,839
Provision for Income Taxes	950	910	910
NET INCOME	$ 2,007	$ 2,042	$ 1,929

PER SHARE DATA	3-Month Period Ended:		
(UNAUDITED)	3/31/2004	12/31/2003	3/31/2003
Basic Earnings Per Share	$ 0.18	$ 0.18	$ 0.17
Diluted Earnings Per Share	$ 0.17	$ 0.17	$ 0.17
Weighted Average Basic Shares Outstanding	11,375,388	11,280,892	11,135,467
Weighted Average Diluted Shares Outstanding	11,798,329	11,697,883	11,396,899
Common Shares Outstanding	11,495,008	11,381,037	11,222,564
Book Value Per Share	$ 8.12	$ 7.89	$ 7.50
Tangible Book Value Per Share	$ 8.12	$ 7.89	$ 7.50

KEY FINANCIAL RATIOS	3-Month Period Ended:		
(UNAUDITED)	3/31/2004	12/31/2003	3/31/2003
Return on Average Equity	8.83%	9.18%	9.32%

Return on Average Assets	0.82%	0.82%	0.85%
Net Interest Margin	4.38%	4.34%	4.64%
Efficiency Ratio	71.01%	72.96%	67.25%

AVERAGE BALANCES	3-Month Period Ended:		
(IN $000'S, UNAUDITED)	3/31/2004	12/31/2003	3/31/2003
Average Assets	$ 979,787	$ 989,646	$ 922,956
Average Earning Assets	$ 898,992	$ 905,932	$ 846,099
Average Gross Loans & Leases	$ 660,446	$ 654,322	$ 663,361
Average Deposits	$ 824,714	$ 838,463	$ 804,008
Average Equity	$ 91,380	$ 88,278	$ 83,948

150 Almaden Boulevard o San Jose, California 95113 o (408) 947-6900 o fax (408) 947-6910

CONSOLIDATED BALANCE SHEET	End Of Period:		
(IN $000'S, UNAUDITED)	3/31/2004	12/31/2003	3/31/2003
ASSETS			
Cash and Due from Banks	$ 51,725	$ 42,017	$ 42,663
Fed Funds Sold	67,700	72,200	81,300
Investment Securities	207,213	155,977	102,392
Loans Held For Sale	25,512	30,638	26,776
Loans:			
Real Estate - Mortgage	287,833	276,908	250,668
Real Estate- Land and Construction	101,389	101,082	141,165
Commercial Loans	275,536	281,561	256,359
Direct Financing Lease	3,749	3,931	0
Consumer Loans	1,715	1,743	2,823
Gross Loans	670,222	665,225	651,015
Deferred Loan Costs	517	863	511
Loans, Net of Deferred Costs	670,739	666,088	651,526
Allowance for Loan Losses	(12,151)	(13,451)	(14,247)
Net Loans	658,588	652,637	637,279
Premises & Equipment, Net	3,711	4,034	4,880

Accrued Interest Receivable and Other Assets	46,274	45,698	47,825
TOTAL ASSETS	$1,060,723	$1,003,201	$ 943,115
LIABILITIES & SHAREHOLDER'S EQUITY			
Liabilities:			
Deposits			
Demand Deposits - Noninterest Bearing	$ 287,633	$ 238,423	$ 245,203
Demand Deposits - Interest Bearing	108,764	105,260	94,499
Savings/ Money Market	340,212	345,886	303,278
Time Deposits, Under $100	39,724	39,869	45,154
Time Deposits, $100 and Over	108,652	105,972	136,492
Total Deposits	884,985	835,410	824,626
Other Borrowings	48,600	43,600	0
Notes Payable To Subsidiary Grantor Trusts	23,702	23,702	23,000
Accrued Interest Payable and Other Liabilities	10,057	10,643	11,346
Total Liabilities	967,344	913,355	858,972
Shareholders' Equity:			
Common Stock	65,395	64,791	63,657
Accumulated Other Comprehensive Income, Net of Taxes	1,000	79	1,362
Retained Earnings	26,984	24,976	19,124
Total Shareholders' Equity	93,379	89,846	84,143
TOTAL LIABILITIES FR SHAREHOLDERS' EQUITY	$1,060,723	$1,003,201	$ 943,115

CREDIT QUALITY DATA	End Of Period:		
(IN $000'S, UNAUDITED)	3/31/2004	12/31/2003	3/31/2003
Nonaccrual Loans	$ 4,171	$ 3,972	$ 4,800
Over 90 Days Past Due and Still Accruing	630	608	0
Other Real Estate Owned	0	0	0
TOTAL NONPERFORMING ASSETS	$ 4,801	$ 4,580	$ 4,800
Net Charge-offs/(Recoveries)	1,901	(12)	280
Net Charge-offs/(Recoveries) as Percent of Average Loans	1.16%	-0.01%	0.17%
Allowance for Loan Losses to Total Loans	1.81 %	2.02%	2.19%
Allowance for Loan Losses to Nonperforming Loans	253.04%	293.69%	296.81%
Nonperforming Assets to Total Assets	0.45%	0.46%	0.51%
Nonperforming Loans to Total Loans	0.72%	0.69%	0.74%

OTHER PERIOD-END STATISTICS	End Of Period:		
(IN $000'S, UNAUDITED)	3/31/2004	12/31/2003	3/31/2003
Shareholders' Equity / Total Assets	8.80%	8.96%	8.92%
Loan to Deposit Ratio	75.79%	79.73%	79.01%
Noninterest Bearing Deposits / Total Deposits	32.50%	28.54%	29.74%
Leverage Ratio	11.54%	11.17%	11.25%