HERITAGE COMMERCE CORP
Form 10-Q
August 04, 2017
Table of Contents

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.

HERITAGE COMMERCE CORP

QUARTERLY REPORT ON FORM 10 Q

TABLE OF CONTENTS

Table of Contents

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;

Table of Contents

- 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.

Table of Contents

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

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

Table of Contents

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

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

Table of Contents

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

Table of Contents

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 Other Comprehensive	Total Shareholders'
	Shares	Amount	Shares	Amount	Earnings	Income / (Loss)	Equity
	(Dollars in thousands)						
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 fortfeitures 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	—	13,987
Other comprehensive income	—	—	—	—	—	1,447	1,447
Issuance of restricted stock awards, net	—	—	81,886	—	—	—	—
Amortization of restricted stock awards, net of forfeitures and taxes	—	—	—	450	—	—	450
Cash dividend declared $0.20 per share	—	—	—	—	(7,604)	—	(7,604)
Stock option expense, net of forfeitures and taxes	—	—	—	441	—	—	441
Stock options exercised	—	—	97,370	660	—	—	660
Balance, June 30, 2017	—	—	38,120,263	$ 216,788	$ 58,910	$ (6,467)	$ 269,231

See notes to unaudited consolidated financial statements

8

Table of Contents

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Six Months Ended June 30,	
	2017	2016
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 13,987	$ 13,401
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of discounts and premiums on securities	2,079	1,746
(Gain) loss on sale of securities available-for-sale	6	(527)
(Gain) loss on sale of SBA loans	(488)	(584)
Proceeds from sale of SBA loans originated for sale	6,133	8,398
Net change in SBA loans originated for sale	(6,051)	(8,187)
Provision (credit) for loan losses	275	752
Increase in cash surrender value of life insurance	(842)	(889)
Depreciation and amortization	385	361
Amortization of other intangible assets	787	784
Stock option expense, net	441	482
Amortization of restricted stock awards, net	450	296
Gain on proceeds from company owned life insurance	—	(1,019)
Effect of changes in:		
Accrued interest receivable and other assets	1,340	3,280
Accrued interest payable and other liabilities	(1,385)	(3,359)
Net cash provided by operating activities	17,117	14,935
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of securities available-for-sale	(87,612)	(75,803)
Purchase of securities held-to-maturity	(62,594)	(109,934)
Maturities/paydowns/calls of securities available-for-sale	25,788	27,789
Maturities/paydowns/calls of securities held-to-maturity	19,795	8,591
Proceeds from sales of securities available-for-sale	6,536	49,171
Net change in loans	(61,293)	(102,413)
Changes in Federal Home Loan Bank stock and other investments	(2,103)	(2,496)
Purchase of premises and equipment	(490)	(130)
Proceeds from sale of foreclosed assets	—	49
Proceeds from company owned life insurance	—	3,164
Net cash used in investing activities	(161,973)	(202,012)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in deposits	112,591	11,009
Issuance of subordinated debt, net of issuance costs	39,119	—

Exercise of stock options	660	623
Repayment of short-term borrowings	—	(3,000)
Payment of cash dividends	(7,604)	(6,803)
Net cash provided by financing activities	144,766	1,829
Net decrease in cash and cash equivalents	(90)	(185,248)
Cash and cash equivalents, beginning of year	266,103	344,092
Cash and cash equivalents, end of year	$ 266,013	$ 158,844
Supplemental disclosures of cash flow information:		
Interest paid	$ 1,842	$ 1,512
Income taxes paid	8,086	4,955
Supplemental schedule of non-cash investing activity:		
Due to broker for securities purchased	$ 2,391	$ —
Transfer of loans held-for-sale to loan portfolio	2,391	2,791
Loans transferred to foreclosed assets	—	49

See notes to unaudited consolidated financial statements

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(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 (“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, 2016.

The Company acquired Focus Business Bank (“Focus”) on August 20, 2015. Focus was merged with HBC, with HBC as the surviving bank.

HBC is a commercial bank serving customers primarily located in Santa Clara, Alameda, Contra Costa, and San Benito counties of California. BVF/CSNK Acquisition Corp., a Delaware corporation (“BVF/CSNK”), the parent company of CSNK Working Capital Finance Corp. dba Bay View Funding (“Bay View Funding”) is a wholly owned subsidiary of HBC, and 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. The Company reports its results for two segments: banking and factoring. The Company’s management uses segment results in its operating and strategic planning.

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, 2017 are not necessarily indicative of the results expected for any subsequent period or for the entire year ending December 31, 2017.

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 March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-09, Compensation—Stock Compensation: Improvements to Employee Share Based Payment Accounting. The standard is intended to simplify several areas of accounting for share based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. All excess tax benefits and tax deficiencies (including tax benefits of dividends on share based payment awards) should be recognized as income tax expense or benefit in the income statement. The tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. An entity also should recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. Excess tax benefits should be classified along with other income tax cash flows as an operating activity. An entity can make an entity wide accounting

Table of Contents

policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. The threshold to qualify for equity classification permits withholding up to the maximum statutory tax rates in the applicable jurisdictions. The Company adopted the new guidance on January 1, 2017. The amount of the impact on the effective tax rate will be determined by the number of stock options exercised and the stock price of the Company when the stock options are exercised, and the amount of restricted stock awards vesting. The adoption of this guidance resulted in net income tax expense of $60,000 for the second quarter of 2017, and a reduction to income tax expense of ($112,000) for the first quarter of 2017, totaling a net reduction to income tax expense of ($52,000) for the first six months of 2017. In connection with the adoption, the Company has elected to estimate forfeitures each reporting period.

Newly Issued, but not yet Effective Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which was 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 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 currently evaluating the impact of adopting the new guidance on the consolidated financial statements. Our preliminary finding is that the new pronouncement will not have a significant impact on the consolidated financial statements as the majority of our business transactions will not be subject to this pronouncement.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Recognition and Measurement of Financial Assets and Liabilities. The new guidance is intended to improve the recognition and measurement of financial instruments by requiring: equity investments (other than equity method or consolidation) to be measured at fair value with changes in fair value recognized in net income; public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; separate presentation of financial assets and financial liabilities by measurement category and form of financial assets (i.e. securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement to disclose the fair value of financial instruments measured at amortized cost for organizations that are not public business entities; eliminating the requirement for non-public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is to be required to be disclosed for financial instruments measured at amortized cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from the change in the instrument-specific credit risk (also referred to as "own credit") when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The new guidance is effective for public business entities for fiscal years beginning after December 15, 2017. We are currently evaluating the impact of adopting the new guidance on the consolidated financial statements. Our preliminary finding is that the new pronouncement will not have a significant impact on our Statement of Operations as the majority of the Company's investment securities are classified as available-for-sale and held-to-maturity debt securities. The pronouncement will require some revision to our disclosures within the consolidated financial statements and we are currently evaluating the impact.

In February 2016, the FASB issued ASU No. 2016-02, Leases. The standard requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right of use asset representing its right to use the underlying asset for the lease term. When measuring assets and liabilities arising from a lease, a lessee (and a lessor) should include payments to be made in optional periods only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease. Similarly, optional payments to purchase the underlying asset should be included in the measurement of lease assets and lease liabilities only if the lessee is reasonably certain to exercise that purchase option. Reasonably certain is a high threshold that is consistent with and intended to be applied in the same way as the reasonably assured threshold in the previous leases

Table of Contents

guidance. In addition, also consistent with the previous leases guidance, a lessee (and a lessor) should exclude most variable lease payments in measuring lease assets and lease liabilities, other than those that depend on an index or a rate or are in substance fixed payments. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight line basis over the lease term. The new guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the impact of adopting the new guidance on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments—Credit Losses: Measurement of Credit Losses on Financial Instruments. The standard is the final guidance on the new current expected credit loss (“CECL”) model. The amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to estimate future credit loss estimates. As CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization’s reasonable and supportable estimate of expected credit losses extends to held to maturity debt securities. The update amends the accounting for credit losses on available for sale securities, whereby credit losses will be presented as an allowance as opposed to a write down. In addition, CECL will modify the accounting for purchased loans with credit deterioration since origination, so that reserves are established at the date of acquisition for purchased loans. Lastly, the amendment requires enhanced disclosures on the significant estimates and judgments used to estimate credit losses, as well as on the credit quality and underwriting standards of an organization’s portfolio. These disclosures require organizations to present the currently required credit quality disclosures disaggregated by the year of origination or vintage. The guidance allows for a modified retrospective approach with a cumulative effect adjustment to the balance sheet upon adoption (charge to retained earnings instead of the income statement). The new guidance is effective for public business entities for fiscal years, and interim periods within those years, beginning after December 15, 2019, and early adoption is permitted. We have formed a committee that is assessing our data and system needs and are evaluating the impact of adopting the new guidance. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In January 2017, the FASB issued accounting standards ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. The provisions of the update eliminate the existing second step of the goodwill impairment test which provides for the allocation of reporting unit fair value among existing assets and liabilities, with the net remaining amount representing the implied fair value of goodwill. In replacement of the existing goodwill impairment rule, the update will provide that impairment should be recognized as the excess of any of the reporting unit’s goodwill over the fair value of the reporting unit. Under the provisions of this update, the amount of the impairment is limited to the carrying value of the reporting unit’s goodwill. For public business entities that are SEC filers, the amendments of the update will become effective in fiscal years beginning after December 15, 2019. Management does not expect the requirements of this update to have a material impact on the Company’s financial position, results of operations or cash flows.

2) Shareholders' Equity and Earnings Per Share

On September 12, 2016, the Company, entered into Exchange Agreements with Castle Creek Capital Partners IV, LP, Patriot Financial Partners, L.P. and Patriot Financial Partners Parallel, L.P. (collectively "Preferred Stockholders") providing for the exchange of 21,004 shares of the Company's Series C convertible perpetual preferred stock, no par value (" Series C Preferred Stock") for 5,601,000 shares of the Company's common stock, no par value. The exchange ratio was equal to the equivalent number of shares the Preferred Stockholders would have received upon conversion of the Series C Preferred Stock.

Table of Contents

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 participated in the earnings of the Company prior to the exchange for common stock and, therefore, the shares issued on the conversion of the Series C Preferred Stock were 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:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands, except per share amounts)			
Net income available to common shareholders	$ 7,449	$ 6,791	$ 13,987	$ 12,393
Less: 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
Weighted average common shares outstanding for basic earnings per common share	38,070,042	32,243,935	38,014,020	32,184,825
Dilutive effect of stock options oustanding, using the the treasury stock method	509,092	268,676	521,995	260,691
Shares used in computing diluted earnings per common share	38,579,134	32,512,611	38,536,015	32,445,516
Basic earnings per share	$ 0.20	$ 0.19	$ 0.37	$ 0.35
Diluted earnings per share	$ 0.19	$ 0.19	$ 0.36	$ 0.35

3) Accumulated Other Comprehensive Income (Loss) (“AOCI”)

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

Three Months Ended June 30, 2017 and 2016
Unamortized
Unrealized

	Unrealized Gains (Losses) on Available-for-Sale Securities and I/O Strips(1)	Gain on Available-for-Sale Securities Reclassified to Held-to-Maturity	Defined Benefit Pension Plan Items	Total
	(Dollars in thousands)			
Beginning balance April 1, 2017, net of taxes	$ (46)	$ 328	$ (7,687)	$ (7,405)
Other comprehensive income (loss) before reclassification, net of taxes	923	—	(8)	915
Amounts reclassified from other comprehensive income (loss), net of taxes	—	(7)	30	23
Net current period other comprehensive income (loss), net of taxes	923	(7)	22	938
Ending balance June 30, 2017, net of taxes	$ 877	$ 321	$ (7,665)	$ (6,467)
Beginning balance April 1, 2016, net of taxes	$ 3,792	$ 395	$ (7,685)	$ (3,498)
Other comprehensive income before reclassification, net of taxes	1,579	—	(5)	1,574
Amounts reclassified from other comprehensive income (loss), net of taxes	(201)			