

HERITAGE COMMERCE CORP  
Form S-4  
April 11, 2007

As filed with the Securities and Exchange Commission on April 11, 2007

Registration No. 333 [       ]

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## Form S-4

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

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### Heritage Commerce Corp

(Exact name of registrant as specified in its charter)

**California**  
(State or other jurisdiction of incorporation)

**6021**  
(Primary Standard Industrial Classification  
Code Number)

**77-0469558**  
(I.R.S. Employer Identification No.)

**Heritage Commerce Corp**  
150 Almaden Boulevard  
San Jose, California 95113  
(408) 947-6900

(Address, including Zip Code, and Telephone Number, including Area Code, of Registrant's Principal Executive Offices)

**Lawrence D. McGovern,**  
Executive Vice President and Chief Financial Officer  
Heritage Commerce Corp  
150 Almaden Boulevard  
San Jose, California 95113  
(408) 947-6900

(Name, Address, including Zip Code, and Telephone Number, including Area Code, of Agent for Service)

**With copies to:**

**Mark A. Bonenfant, Esq.**  
Buchalter Nemer  
a professional corporation  
1000 Wilshire Blvd, 15th Floor  
Los Angeles, California 90017  
(213) 891-0700

**James M. Rockett, Esq.**  
Bingham McCutchen, LLP  
3 Embarcadero Center  
San Francisco, California 94111  
(415) 393-2025

**Approximate date of commencement of the proposed sale of the securities to the public:** As soon as practicable after this Registration Statement becomes effective and upon completion of the merger described in the enclosed document.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box.

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If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, as amended, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

### CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to Be Registered	Amount to Be Registered	Proposed Maximum Offering Price per Share of Common Stock	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Common stock, no par value	1,732,298 (1)	N/A	\$40,225,593	\$1,235 (2)

(1) Represents the maximum number of shares of Heritage Commerce Corp common stock estimated to be issuable upon the completion of the merger of Diablo Valley Bank with and into Heritage Bank of Commerce pursuant to the formula set forth in the Agreement and Plan of Merger, dated as of February 8, 2007, by and between Heritage Commerce Corp, Heritage Bank of Commerce and Diablo Valley Bank.

(2) Pursuant to Rules 457(c) and 457(f) under the Securities Act of 1933, as amended, the registration fee is based on the closing price of Diablo Valley Bank common stock, as reported on the Over-the-Counter Bulletin Board as of April 9, 2007 (\$22.05), and computed based on the estimated maximum number of shares that may be exchanged for the Heritage Commerce Corp common stock being registered (2,505,146), less the estimated amount of cash to be paid by Heritage Commerce Corp in exchange for shares of Diablo Valley Bank common stock (\$15,012,876).

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such dates as the Commission, acting pursuant to said Section 8(a), may determine.**

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PRELIMINARY SUBJECT TO COMPLETION DATED APRIL , 2007

The information in this proxy statement/prospectus is not complete and may be changed. We may not sell the securities offered by this proxy statement/prospectus until the registration statement filed with the Securities and Exchange Commission is effective. This proxy statement/prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction where an offer or solicitation is not permitted.

## **MERGER PROPOSED YOUR VOTE IS VERY IMPORTANT**

Dear Shareholder,

On February 8, 2007, Diablo Valley Bank entered into an agreement and plan of merger with Heritage Commerce Corp and Heritage Bank of Commerce pursuant to which Diablo Valley Bank will merge with and into Heritage Bank of Commerce, with Heritage Bank of Commerce as the surviving corporation in the merger. You are cordially invited to attend a special meeting of the shareholders of Diablo Valley Bank on [\*] at 5:30 p.m., local time, at 387 Diablo Road, Danville, California 94526 to vote on approval of the merger. We are sending you this proxy statement/prospectus to ask you to vote on the approval of the merger at the special meeting.

If the merger is completed, Diablo Valley Bank common stock shareholders may elect to receive cash or Heritage Commerce Corp common stock in exchange for their shares of Diablo Valley Bank common stock, subject to certain limitations described in this document. The value you receive in exchange for your Diablo Valley Bank common stock is dependent on the *per share consideration*. The *per share consideration* is calculated by reference to the Heritage Commerce Corp common stock average closing price over a 20 day trading period that ends on the 5th business day before the effective date of the merger. The *per share consideration*, however, will never be less than \$23.00, and depending on the average trading price of the Heritage Commerce Corp common stock, the *per share consideration* could be higher than \$23.00. Based on the Heritage Commerce Corp closing sale price on [\*], 2007 (the last practicable date before this document was mailed) of \$[\*], you would receive \$[\*] in value for each share of Diablo Valley Bank common stock. The *per share consideration* will float within a band of \$23.00 to \$25.00 if the average closing price is between \$24.55 and \$27.44. If the average closing price is above \$27.44, the *per share consideration* will be increased to reflect one-third of the increase in the average closing price above \$27.44. If the average closing price is below \$24.55, the aggregate amount of cash paid in the merger will be increased to an amount necessary to maintain a minimum *per share consideration* of \$23.00. If the average closing price falls below \$23.50, Heritage Commerce Corp has the right to terminate the merger.

Subject to the allocation provisions of the merger agreement, you may elect to receive all cash or all Heritage Commerce Corp common stock for the Diablo Valley Bank shares you own.

- If you elect cash, the amount you receive per share will be equal to the *per share consideration*.
- If you elect Heritage Commerce Corp common stock, the number of shares that you will receive will be equal to the number of your Diablo Valley Bank shares multiplied by an *exchange ratio*. The *exchange ratio* will be calculated by dividing the *per share consideration* by the *average closing price*. To the extent that the formula results in a fraction of a share, such fraction will not be issued but you will receive cash in lieu of such fractional interest.

The market prices of Heritage Commerce Corp common stock and Diablo Valley Bank common stock will fluctuate before the merger. You should obtain current stock price quotations for Heritage Commerce Corp common stock and Diablo Valley Bank common stock. Heritage Commerce Corp common stock is quoted on the NASDAQ Global Select Market under the symbol HTBK. Diablo Valley Bank common stock is quoted on the Over-the-Counter Bulletin Board under the symbol DBVB

We expect that the merger will generally be tax-free to you as to shares of Heritage Commerce Corp common stock you receive in the merger and generally taxable to you as to the cash you receive.

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It is a condition to the merger that the holders of Diablo Valley Bank's series A preferred stock will have their shares of series A preferred stock redeemed by Diablo Valley Bank for \$32.00 per share in cash prior to the merger.

We cannot complete the merger unless Diablo Valley Bank's common shareholders and holders of the series A preferred stock approve the merger. In order for the merger to be approved, the holders of at least a majority of Diablo Valley Bank's outstanding common shares and series A preferred shares, each voting as a separate class, must vote in favor of the merger. The members of the Board of Directors of Diablo Valley Bank, who in the aggregate have the power to vote approximately 28% of the outstanding shares of Diablo Valley Bank common stock and 19% of the outstanding series A preferred stock, have each executed voting agreements with Heritage Commerce Corp pursuant to which they have agreed to vote their shares of Diablo Valley Bank common stock in favor of the merger and against any competing business combination transaction. Regardless of whether you plan to attend the special shareholders' meeting, please take the time to vote your shares in accordance with the instructions contained in this document. Failing to vote will have the same effect as voting against the merger. The Diablo Valley Bank Board of Directors recommends that Diablo Valley Bank shareholders vote **FOR** approval of the merger.

**Also enclosed is an election form and instructions for electing your preferred form of merger consideration and exchanging your shares of Diablo Valley Bank common stock for shares of Heritage Commerce Corp and any cash payments you may be entitled to receive. Please complete and return your election form together with your Diablo stock certificates in the separate BLUE envelope that is provided for that purpose. If you hold your shares in street name through a bank or broker, you should follow instructions from your bank or broker to vote your shares, complete the required election and transmittal materials and submit your shares in exchange for the merger consideration.**

This document describes the special meeting, the merger, the documents related to the merger and other related matters. Please carefully read this entire document, including the Risk Factors section beginning on page [\*] for a discussion of the risks relating to the proposed merger. You also can obtain information about Heritage Commerce Corp from documents that it has filed with the Securities and Exchange Commission.

John J. Hounslow

*Chairman of the Board  
Diablo Valley Bank*

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved the Heritage Commerce Corp common stock to be issued under this document or determined if this document is accurate or adequate. Any representation to the contrary is a criminal offense.**

The date of this document is [\*], and it is first being mailed or otherwise delivered to Diablo Valley Bank shareholders on or about [\*].

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**DIABLO VALLEY BANK**  
387 Diablo Road  
Danville, California 94526

**NOTICE OF SPECIAL MEETING OF SHAREHOLDERS**

Diablo Valley Bank will hold a special meeting of shareholders at 387 Diablo Road, Danville, California 94526 at 5:30p.m., local time on [\*], 2007 to consider and vote upon the following proposals:

- to approve the merger of Diablo Valley Bank with and into Heritage Bank of Commerce, a wholly-owned subsidiary of Heritage Commerce Corp, on the terms set forth in the Agreement and Plan of Merger, dated as of February 8, 2007, by and between Heritage Commerce Corp, Heritage Bank of Commerce and Diablo Valley Bank, as it may be amended from time to time; and
- to approve the adjournment of the special meeting, if necessary, to solicit additional proxies, in the event that there are not sufficient votes at the time of the special meeting to approve the proposal to approve the merger.

The Diablo Valley Bank Board of Directors has fixed the close of business on [\*], 2007 as the record date for the special meeting. Only holders of Diablo Valley Bank common stock and series A preferred stock of record at that time are entitled to notice of, and to vote at, the special meeting or any adjournment or postponement of the special meeting.

In order for the merger to be approved, the holders of at least a majority of the Diablo Valley Bank common stock and of the series A preferred stock outstanding and entitled to vote thereon must vote in favor of approval of the merger.

**Regardless of whether you plan to attend the special meeting, please submit your proxy with voting instructions. Please vote as soon as possible. If you hold stock in your name as a shareholder of record, please complete, sign, date and return the accompanying proxy card in the enclosed WHITE self-addressed, stamped envelope (or vote by telephone or internet in accordance with instructions on your proxy card). If you hold your stock in street name through a bank or broker, please direct your bank or broker to vote in accordance with the instructions you have received from your bank or broker. This will not prevent you from voting in person, but it will help to secure a quorum and avoid added solicitation costs. Any holder of Diablo Valley Bank common stock or series A preferred stock who is present at the special meeting may vote in person instead of by proxy, thereby canceling any previous proxy. In any event, a proxy may be revoked in writing at any time before the special meeting in the manner described in the accompanying document.**

Holders of Diablo Valley Bank common stock who do not vote in favor of approving the merger agreement and who otherwise comply with the requirements of California law will be entitled to appraisal rights. A summary of the applicable California law provision, including the requirements a Diablo Valley Bank shareholder must follow in order to exercise his or her appraisal rights, is contained in the accompanying proxy statement/prospectus. A copy of the California law provision relating to appraisal rights is attached as Appendix C to the proxy statement/prospectus.

**The Diablo Valley Bank Board of Directors has approved the merger and the merger agreement and recommends that Diablo Valley Bank shareholders vote FOR approval of the merger.**

**YOUR VOTE IS IMPORTANT. PLEASE VOTE YOUR SHARES PROMPTLY, REGARDLESS OF WHETHER YOU PLAN TO ATTEND THE SPECIAL MEETING. YOU CAN FIND INSTRUCTIONS FOR VOTING ON THE ENCLOSED PROXY CARD.**

BY ORDER OF THE BOARD OF DIRECTORS,

*Alfred D. McKelvy, Jr., Corporate Secretary*  
[\*], 2007



**REFERENCES TO ADDITIONAL INFORMATION**

This document, which is sometimes referred to as this proxy statement/prospectus, constitutes a proxy statement of Diablo Valley Bank to Diablo Valley Bank shareholders with respect to the solicitation of proxies for the special meeting described within and a prospectus of Heritage Commerce Corp for the shares of Heritage Commerce Corp common stock that Heritage Commerce Corp will issue to Diablo Valley Bank shareholders in the merger. This document incorporates important business and financial information about Heritage Commerce Corp from documents filed with the Securities and Exchange Commission (the SEC) that are not included in or delivered with this document. You may obtain copies of these documents, without charge, from the web site maintained by the SEC at [www.sec.gov](http://www.sec.gov), as well as other sources. See

Where You Can Find More Information beginning on page [\*]. You can also obtain documents incorporated by reference in this document, other than certain exhibits to those documents, by requesting them in writing or by telephone from Heritage Commerce Corp at the following address:

**Heritage Commerce Corp**  
**150 Almaden Boulevard**  
**San Jose, California 95113**  
**Attention: Corporate Secretary**  
**(408) 947-6900**

*You will not be charged for any of these documents that you request. Diablo Valley Bank shareholders requesting documents should do so by [\*] in order to receive them before the special meeting.*

See Where You Can Find More Information on page [\*].

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## QUESTIONS AND ANSWERS ABOUT THE SPECIAL MEETING

*The questions and answers below highlight only selected procedural information from this document. They do not contain all of the information that may be important to you. You should read carefully the entire document and the additional documents incorporated by reference into this document to fully understand the voting procedures for the special meeting.*

### **Q: What is the proposed transaction for which I am being asked to vote?**

A: You are being asked to vote to adopt an Agreement and Plan of Merger, dated as of February 8, 2007, by and between Heritage Commerce Corp, Heritage Bank of Commerce and Diablo Valley Bank. Subject to the terms and conditions of the merger agreement, Diablo Valley Bank would merge with and into Heritage Bank of Commerce, a wholly-owned subsidiary of Heritage Commerce Corp, as the surviving corporation in the merger.

You are also being asked to give the proxyholders the authority to approve an adjournment of the special meeting, if necessary, to solicit additional proxies in the event there are not sufficient votes at the time of the special meeting to approve the proposed merger.

### **Q: When and where is the special meeting?**

A: The special meeting is scheduled to take place at 387 Diablo Road, Danville, California 94526 at 5:30p.m., local time on [ \* ], 2007.

### **Q: What do I need to do now?**

A: After you have carefully read this document and have decided how you wish to vote your shares, please vote your shares promptly. If you hold stock in your name as a shareholder of record, you must complete, sign, date and mail your proxy card in the enclosed postage paid return **WHITE** envelope as soon as possible (or vote by telephone or internet in accordance with instructions on your proxy card). If you hold your stock in street name through a bank or broker, you must direct your bank or broker to vote in accordance with the instructions you have received from your bank or broker. Submitting your proxy card or directing your bank or broker to vote your shares will ensure that your shares are represented and voted at the special meeting.

You should also complete the election form and transmittal materials that accompany this proxy statement/prospectus to specify the merger consideration you prefer (or provide instructions to your broker if you hold your shares in street name ) and mail and enclose the election form and transmittal materials in the **BLUE** envelope. To submit your Diablo Valley Bank share certificates for exchange, you should follow the instructions in the election form and transmittal materials.

### **Q: What vote is required to approve the merger agreement?**

A: The merger agreement must be approved by the holders of a majority of the outstanding shares of Diablo Valley Bank common stock entitled to vote at the special meeting and by the holders of a majority of the series A preferred stock, each voting as a separate class. This means that if either the common stock shareholders as a class do not vote to approve the merger or the series A preferred shareholders as a class do not vote to approve the merger then the merger will not go forward. The Diablo Valley Bank Board of Directors recommends that you vote **FOR** approval of the merger. The members of the Board of Directors of Diablo Valley Bank, who in the aggregate have the power to vote approximately 28% of the outstanding shares of Diablo Valley Bank common stock and 19% of the outstanding shares of series A preferred stock, have each executed voting agreements with Heritage Commerce Corp pursuant to which they have agreed to vote their shares of Diablo Valley Bank common stock in favor of the merger and against any competing business combination transaction.



**Q: If my shares of common stock are held in street name by my broker, will my broker automatically vote my shares for me?**

A: No. Your broker cannot vote your shares without instructions from you. You should instruct your broker as to how to vote your shares, following the directions your broker provides to you. Please check the voting form used by your broker.

**Q: What if I fail to instruct my broker?**

A: If you do not provide your broker with instructions, your broker generally will not be permitted to vote your shares on the merger proposal being presented at the special meeting. Because the approval of the merger requires the affirmative vote of the holders of a majority of the outstanding shares of Diablo Valley Bank common stock and the series A preferred stock, a failure to provide your broker instructions will have the same effect as a vote against the merger.

**Q: Can I attend the special meeting and vote my shares in person?**

A: Yes. All shareholders, including shareholders of record and shareholders who hold their shares through banks, brokers, nominees or any other holder of record, are invited to attend the special meeting. Holders of record of Diablo Valley Bank common stock or series A preferred stock can vote in person at the special meeting. If you are not a shareholder of record, you must obtain a proxy, executed in your favor, from the record holder of your shares, such as a broker, bank or other nominee, to be able to vote in person at the special meeting. If you plan to attend the special meeting, you must hold your shares in your own name or have a letter from the record holder of your shares confirming your ownership and you must bring a form of personal photo identification with you in order to be admitted.

**Q: Can I change my vote?**

A: Yes. You may revoke any proxy at any time before it is voted by (1) signing and returning a proxy card with a later date, (2) delivering a written revocation letter to the Secretary of Diablo Valley Bank, or (3) attending the special meeting in person, notifying the Secretary and voting by ballot at the special meeting. The Diablo Valley Bank Secretary's mailing address is 387 Diablo Road, Danville, California, 94526.

Any shareholder entitled to vote in person at the special meeting may vote in person regardless of whether a proxy has been previously given, and such vote will revoke any previous proxy but the mere presence (without notifying the Secretary of Diablo Valley Bank) of a shareholder at the special meeting will not constitute revocation of a previously given proxy.

**Q: Am I certain to receive the form of merger consideration that I elect for my common stock?**

A: No. The merger agreement provides that the total Diablo Valley Bank shares of common stock outstanding immediately prior to completion of the merger will be converted into total of \$15,012,876 cash and 1,732,298 shares of Heritage Commerce Corp common stock, (subject to adjustment based on the average closing price of the Heritage Commerce Corp common stock over the 20 trading days ending on the fifth trading day immediately before the effective date of the merger). As a result, if more common stock shareholders elect to receive either form of consideration than is available under the merger agreement, shareholders electing the over-subscribed form of consideration will have their elections proportionately reduced and will receive a portion of their consideration in the other form of consideration, despite their election. This mechanism is more fully described in this proxy statement/prospectus under the caption "The Merger Agreement Merger Consideration" beginning on page [\*].



**Q: If I own series A preferred stock will I participate in the merger consideration?**

A: No. It is a condition to the merger that holders of series A preferred stock will have their shares repurchased by Diablo Valley Bank for \$32.00 cash prior to the merger.

**Q: What do I need to do to receive the merger consideration for my common stock?**

A: You will need to sign, date and complete the election form and transmittal materials that accompany this proxy statement/prospectus and submit them in the enclosed **BLUE** envelope to the exchange agent, US Stock Transfer, at the address given in the materials, together with the certificates representing your shares of Diablo Valley Bank common stock prior to the election deadline. The election deadline will be 5:00 [\*] San Francisco, California time one business day immediately preceding the date of the special meeting, and will be separately announced at least five business days, and not more than fifteen business days, prior to the deadline. If you do not submit an election prior to the election deadline, you will be allocated Heritage Commerce Corp common stock and/or cash pursuant to the procedures described under The Merger Agreement Merger Consideration beginning on page [\*]. If your shares are held in street name you will have to provide instructions to your broker to make an election. If you do not make an election, you will receive separate instructions for submitting your Diablo Valley Bank common stock certificates in exchange for the merger consideration following completion of the merger.

**Q: What do I need to do to receive my cash for my series A preferred stock?**

A: Diablo Valley Bank will send a notice of redemption of preferred stock at least 30 days before the redemption date. The notice will include instructions for surrendering your shares for redemption.

**Q: What must I do if I want to seek appraisal rights because I do not want to receive the merger consideration?**

A: Holders of Diablo Valley Bank common stock will have appraisal rights as a result of the proposed merger. If you are a holder of Diablo Valley Bank common stock and wish to dissent from the merger and seek an appraisal of the value of your Diablo Valley Bank common shares you must follow the procedures established under California law, including:

- not voting in favor of the merger,
- delivery of notice of demand for appraisal within 30 days after Diablo Valley Bank mails notice of approval of the merger after the special shareholder meeting, and
- delivery of your common shares to Diablo Valley Bank stock within 30 days after Diablo Valley Bank mails notice of approval of the merger.

These procedures are described in Appendix C of this document and are summarized on pages [\*]-[\*]. Failure to follow the applicable procedures will result in the loss of appraisal rights.

**Q: Can I change my election after I submit my certificates?**

A: Yes. You can revoke your election and submit new election materials prior to the election deadline. You may do so by submitting a written notice to the exchange agent that is received prior to the election deadline. The revocation must specify the account name and such other information as the exchange agent may request; revocations may not be made in part. New elections must be submitted in accordance with the election procedures described in

this proxy statement/prospectus. If you instructed a broker to submit an election for your shares, you must follow your broker's directions for changing those instructions.

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**Q: When do you expect to complete the merger?**

A: We expect to complete the merger in the second or third quarter of 2007. However, we cannot assure you when or if the merger will occur. We must first obtain the approval of Diablo Valley Bank shareholders at the special meeting and the necessary regulatory approvals.

**Q: Will I be able to sell the shares of Heritage Commerce Corp common stock that I receive in the merger?**

A: Yes, in most cases. The shares of Heritage Commerce Corp common stock to be issued in the merger will be registered under the Securities Act of 1933, as amended (which we refer to as the Securities Act), and listed on the NASDAQ Global Select Market. However, certain shareholders who are deemed to be affiliates of Heritage Commerce Corp or Diablo Valley Bank under the Securities Act (generally, directors, executive officers and shareholders of Heritage Commerce Corp or Diablo Valley Bank holding more than 10% of the outstanding shares of common stock) must abide by certain transfer restrictions under the Securities Act.

**Q: What if I do not vote or I abstain from voting?**

A: If you do not vote or you abstain from voting, your failure to vote or abstention will have the effect of a vote against the items being considered.

**Q: What happens if I sell my shares of Diablo Valley Bank common stock before the special meeting?**

A: The record date for the special meeting is [\*], which is earlier than the date of the special meeting. If you hold your shares of Diablo Valley Bank common stock on the record date you will retain your right to vote at the special meeting. If you transfer your shares of Diablo Valley Bank common stock after the record date but prior to the date on which the merger is completed, you will lose the right to receive the merger consideration for shares of Diablo Valley Bank common stock and any dividends that have a record date after the date on which you transfer your shares. The right to receive the merger consideration will pass to the person who owns your shares of Diablo Valley Bank common stock when the merger is completed.

**Q: What will happen to my Diablo Valley Bank shares after completion of the merger?**

A: Upon completion of the merger, your shares of Diablo Valley Bank common stock will be canceled and will represent only the right to receive your portion of the merger consideration (or the fair value of your Diablo Valley Bank common stock if you seek appraisal rights) and any declared but unpaid dividends that you may be owed.

**Q: Whom should I call with questions?**

A: Diablo Valley Bank shareholders should call John J. Hounslow at 925-314-2801 with any questions about the merger.



## SUMMARY

*This summary highlights selected information from this document. It does not contain all of the information that is important to you. We urge you to carefully read the entire document and the other documents to which we refer in order to fully understand the merger and the related transactions. See *Where You Can Find More Information* on page [\*]. Each item in this summary refers to the page of this document on which that subject is discussed in more detail.*

### **Information about the Companies**

#### ***Heritage Commerce Corp***

Heritage Commerce Corp is registered with the Board of Governors of the Federal Reserve System as a Bank Holding Company under the Bank Holding Company Act ( BHCA ). Heritage Commerce Corp was organized in 1997 to be the holding company for Heritage Bank of Commerce. Subsequent to 1997, Heritage Commerce Corp became the holding company for Heritage Bank East Bay ( HBEB ); Heritage Bank South Valley ( HBSV ) and Bank of Los Altos ( BLA ). On January 1, 2003, HBEB, HBSV, and BLA were merged into Heritage Bank of Commerce. The former HBEB, HBSV, and BLA now operate as branch offices of Heritage Bank of Commerce and continue to serve their local markets. Heritage Commerce Corp's principal source of income is dividends from Heritage Bank of Commerce. The expenditures of Heritage Commerce Corp, including (but not limited to) the payment of dividends to shareholders, if and when declared by the Board of Directors, the cost of servicing debt, legal fees, audit fees, and shareholder costs will generally be paid from dividends paid to Heritage Commerce Corp by Heritage Bank of Commerce. At December 31, 2006, Heritage Commerce Corp had consolidated assets of \$1.04 billion, deposits of \$847 million and shareholders' equity of \$123 million. Heritage Commerce Corp common stock is listed on the NASDAQ Global Select Market.

#### ***Heritage Bank of Commerce***

Heritage Bank of Commerce is a California state-chartered bank headquartered in San Jose, California. It was incorporated in November 1993 and opened for business in January 1994. Heritage Bank of Commerce is a multi-community independent bank that offers a full range of banking services to small to medium sized businesses and their owners, managers and employees residing in Santa Clara, Alameda and Contra Costa counties in California. Heritage Bank of Commerce operates nine full service branch offices throughout this geographic footprint.

The principal executive offices of Heritage Commerce Corp and Heritage Bank of Commerce are located at 150 Almaden Boulevard, San Jose, California 95113.

#### ***Diablo Valley Bank***

Diablo Valley Bank is a California state-chartered bank. Diablo Valley Bank operates two offices located at 387 Diablo Road, Danville, California and 300 Main Street, Pleasanton, California. At December 31, 2006, Diablo Valley Bank had total assets of approximately \$249 million, total deposits of approximately \$224 million and total shareholders' equity of approximately \$24.1 million. Diablo Valley Bank common stock is quoted on the Over-the-Counter Bulletin Board. Diablo Valley Bank's principal executive offices are located at 387 Diablo Road in Danville.

### **The Merger and the Merger Consideration (page [\*])**

We are proposing the merger of Diablo Valley Bank with and into Heritage Bank of Commerce, a wholly-owned subsidiary of Heritage Commerce Corp. Heritage Bank of Commerce will survive the merger. As used in this document, the term *the merger* means the merger of Diablo Valley Bank with and into Heritage Bank of Commerce. The merger is governed by the Agreement of Plan and Merger

dated February 8, 2007. A copy of the merger agreement is attached as Appendix A at the back of this proxy statement/prospectus. You are encouraged to read this merger agreement, which is the legal document that governs the merger.

The value that you will receive in exchange for your Diablo Valley Bank common stock is dependent on the *per share consideration* which will be calculated with reference to the average closing price for the Heritage Commerce Corp common stock. *Average closing price* means the average daily closing price of Heritage Commerce Corp common stock during the 20 trading days ending on the fifth trading day immediately before the effective date of the merger.

- *Per share consideration* means:

(i) If the *average closing price* is less than or equal to \$24.55,

then the *per share consideration* is \$23.00

(ii) If the *average closing price* exceeds \$24.55,

then the *per share consideration* will be an amount of the quotient equal to (A) the sum of (x) the product of the *total stock consideration* times the *average closing price*, plus (y) \$15,012,876, divided by (B) 2,502,146

- *Total stock consideration* means:

(i) If the *average closing price* is less than \$27.44, then 1,732,298 shares of Heritage Commerce Corp common stock; and

(ii) If the *average closing price* exceeds \$27.44, then 1,732,298 shares minus the number of shares equal to (A) .6666 times the difference between the *average closing price* and \$27.44 multiplied by 1,732,298, divided by (B) the *average closing price*.

- In general the *per share consideration* will float within a band of \$23.00 to \$25.00 if the *average closing price* is between \$24.55 and \$27.44. If the *average closing price* is above \$27.44, the *per share consideration* will be increased to include one-third of the increase in the *average closing price* above \$27.44. If the *average closing price* is below \$24.55, the aggregate amount of cash paid in the merger will be increased to an amount necessary to maintain a minimum *per share consideration* of \$23.00.

- If the *average closing price* falls below \$23.50, Heritage Commerce Corp has the right to terminate the agreement and plan of merger agreement.

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The following table gives examples of the *exchange ratio*, *per share consideration* and *total consideration* for various *average closing prices* between \$23.00 and \$30.00. The actual *average closing price* could be higher or lower than this range. This table assumes no exercise of outstanding options to acquire Diablo Valley Bank common stock.

Average Closing Price	Per Share Consideration	Exchange Ratio	Total Stock Consideration (Shares)	Value of Stock Consideration	Cash Consideration	Total Consideration
\$23.00	\$ 23.00	1.0000	1,732,298	\$ 39,842,854	\$ 17,697,938	\$ 57,540,792
\$23.50	\$ 23.00	0.9787	1,732,298	\$ 40,709,003	\$ 16,831,789	\$ 57,540,792
\$24.00	\$ 23.00	0.9583	1,732,298	\$ 41,575,152	\$ 15,965,640	\$ 57,540,792
\$24.55	\$ 23.00	0.9369	1,732,298	\$ 42,527,916	\$ 15,012,876	\$ 57,540,792
\$25.00	\$ 23.31	0.9323	1,732,298	\$ 43,307,450	\$ 15,012,876	\$ 58,320,326
\$26.00	\$ 24.00	0.9231	1,732,298	\$ 45,039,748	\$ 15,012,876	\$ 60,052,624
\$27.00	\$ 24.69	0.9145	1,732,298	\$ 46,772,046	\$ 15,012,876	\$ 61,784,922
\$27.44	\$ 25.00	0.9110	1,732,298	\$ 47,534,257	\$ 15,012,876	\$ 62,547,133
\$28.00	\$ 25.13	0.8974	1,709,203	\$ 47,857,684	\$ 15,012,876	\$ 62,870,560
\$29.00	\$ 25.36	0.8744	1,670,180	\$ 48,435,232	\$ 15,012,876	\$ 63,448,108
\$30.00	\$ 25.59	0.8529	1,633,759	\$ 49,012,780	\$ 15,012,876	\$ 64,025,656

Amounts shown in the **Total Consideration** column do not include approximately \$7.5 million that will be paid to holders of options to acquire Diablo Valley Bank common stock (assuming no exercise of such options before completion of the merger). Holders of Diablo Valley Bank preferred stock may convert preferred stock to Diablo Valley Bank common stock on a one-for-one basis before redemption and instead receive the merger consideration, but as indicated above the per share merger consideration for each share of common stock is likely to be substantially less than \$32.00 per share.

Subject to the allocation provisions of the merger agreement, you may elect to receive all cash or all Heritage common stock for the Diablo Valley Bank shares you own.

- If you elect cash, the amount you receive per share will be equal to the *per share consideration*.
- If you elect Heritage Commerce Corp common stock, the number of shares that you will receive will be equal to the number of your Diablo Valley Bank shares multiplied by an *exchange ratio*. The *exchange ratio* will be calculated by dividing the *per share consideration* by the *average closing price*. To the extent that the formula results in a fraction of a share, such fraction will not be issued but you will receive cash in lieu of such fractional interest.

As of the date of this proxy statement/prospectus, Diablo Valley Bank has 2,505,146 shares outstanding. Between the date hereof and the closing for the merger, additional stock options may be exercised. As a result of the additional shares pursuant to the exercise of outstanding stock options, the aggregate consideration to be paid by Heritage Commerce Corp will increase but the *per share consideration* due to Diablo Valley Bank shareholders will not decrease.

If you are a shareholder of record of Diablo Valley Bank common stock you may make different elections with respect to different shares. For example, if you are the record holder of 10,000 shares of Diablo Valley Bank common stock, you may elect to have 3,000 of those shares converted into the cash consideration and 7,000 of those shares converted into the Heritage Commerce Corp common stock consideration, subject to potential adjustment as described below. If you hold your stock in **street name** through a bank or broker, your election procedures may be subject to further limitations imposed by your bank or broker.

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The foregoing discussion applies primarily to holders of Diablo Valley Bank common stock. Holders of its series A preferred stock will receive \$32.00 per share in redemption of those shares before completion of the merger.

### **Risk Factors (page [\*])**

See the section entitled "Risk Factors" beginning on page [\*] for a discussion of risks associated with the merger.

### **Regardless of whether you make a cash election or a stock election, you may nevertheless receive a mix of cash and stock (page [\*])**

The merger agreement provides that the total Diablo Valley Bank shares of common stock outstanding immediately prior to completion of the merger will be converted into the right to receive \$15,012,876 cash, subject to adjustment, and 1,732,298 shares of Heritage Commerce Corp common stock, subject to adjustment. As a result, if more shareholders elect to receive either form of consideration than is available under the merger agreement, shareholders electing the over-subscribed form of consideration will have their elections proportionately reduced and will receive a portion of their consideration in the other form, despite their election.

### **Consideration for Diablo Valley Bank Stock Options (page [\*])**

Upon completion of the merger each outstanding option to purchase shares of Diablo Valley Bank common stock, whether vested or not, will be cancelled and converted into the right to receive a lump sum cash payment, without interest, equal to the product of (1) the number of shares subject to such Diablo Valley Bank option and (2) the excess, if any, of the per share consideration over the exercise price per share of such Diablo Valley Bank option, subject to applicable tax withholding.

### **The Merger Will Generally Be Tax-Free to Diablo Valley Bank Shareholders Except to the Extent of the Cash They Receive (page [\*])**

Heritage Commerce Corp and Diablo Valley Bank have structured the merger to qualify as a reorganization for United States federal income tax purposes, and it is a condition to their respective obligations to complete the merger that each of Heritage Commerce Corp and Diablo Valley Bank receive a legal opinion to that effect. Accordingly, the merger will generally be tax-free to you, except to the extent of the cash you receive in the merger. The amount of gain that you recognize in the merger will generally be limited to the lesser of the amount of gain that you realize and the amount of cash that you receive in the merger (except for any cash you receive instead of fractional shares). The amount of gain that you realize is generally equal to the excess, if any, of the sum of the cash and the fair market value of the Heritage Commerce Corp common stock that you receive over your tax basis in the Diablo Valley Bank common stock you surrender in the merger.

*The United States federal income tax consequences described above may not apply to all holders of Diablo Valley Bank common stock. Your tax consequences will depend on your individual situation. Accordingly, we strongly urge you to consult your tax advisor for a full understanding of the particular tax consequences of the merger to you*

### **Comparative Market Prices and Share Information (pages [\*] and [\*])**

Heritage Commerce Corp common stock is quoted on the NASDAQ Global Select Market under the symbol HTBK. Diablo Valley Bank common stock is quoted on the Over-the-Counter Bulletin Board under the symbol DBVB. The following table shows the closing sale prices of Heritage Commerce Corp common stock and Diablo Valley Bank common stock as reported on the NASDAQ Global Select Market

and the Over-the-Counter Bulletin Board, respectively, on February 8, 2007, the last trading day before we announced the merger, and on [\*], the last practicable trading day before the distribution of this document. This table also shows the implied value of the consideration proposed for each share of Diablo Valley Bank common stock receiving Heritage Commerce Corp common stock in the merger, which was calculated by multiplying the closing price of Heritage Commerce Corp common stock on those dates by .9127 and [\*], the respective exchange ratios that would result if the applicable average Heritage Commerce Corp trading price were equal to the Heritage Commerce Corp closing prices on such dates.

	<b>Heritage Commerce Corp Common Stock</b>	<b>Diablo Valley Bank Common Stock</b>	<b>Equivalent Value of Pro Forma Price Per Share</b>
At February 8, 2007	\$ 27.25	\$ 24.00	\$ 24.87
At [*]	\$ [*]	\$ [*]	\$ [*]

*The market price of Heritage Commerce Corp common stock and Diablo Valley Bank common stock will fluctuate prior to the merger. You should obtain market quotations for the shares.*

**Howe Barnes Hoefler & Arnett Has Provided an Opinion to the Diablo Valley Bank Board of Directors Regarding the Merger Consideration (page [\*])**

Howe Barnes Hoefler & Arnett delivered its opinion to Diablo Valley Bank's Board of Directors that as of February 8, 2007, and based upon and subject to the factors and assumptions set forth in the opinion, the merger consideration to be received by holders of the outstanding shares of the common stock of Diablo Valley Bank under the agreement and plan of merger was fair from a financial point of view.

The full text of the written opinion of Howe Barnes Hoefler & Arnett, dated February 8, 2007, which sets forth the assumptions made, procedures followed, matters considered and limitations on the review undertaken in connection with the opinion, is attached as Appendix B to this proxy statement/prospectus. Diablo Valley Bank's shareholders are encouraged to read the opinion in its entirety. Howe Barnes Hoefler & Arnett provided its opinion for the information and assistance of the Diablo Valley Bank Board of Directors in connection with its consideration of the transaction. The Howe Barnes Hoefler & Arnett opinion is not a recommendation as to how any holder of Diablo Valley Bank common stock should vote with respect to the transaction.

**The Diablo Valley Bank Board of Directors Recommends that Diablo Valley Bank Shareholders Vote FOR Approval of the Merger (page [\*])**

The Diablo Valley Bank Board of Directors believes that the merger is in the best interests of Diablo Valley Bank and its shareholders and has approved the merger and the merger agreement. The Diablo Valley Bank Board of Directors recommends that Diablo Valley Bank shareholders vote FOR approval of the merger.

**Diablo Valley Bank's Directors and Officers Have Financial Interests in the Merger That May Differ From Your Interests (page [\*])**

In considering the information contained in this document, you should be aware that Diablo Valley Bank's executive officers and directors have financial interests in the merger that may be different from, or in addition to, the interests of Diablo Valley Bank shareholders. These additional interests of Diablo Valley Bank's executive officers and directors may create potential conflicts of interest and cause some of these persons to view the proposed transaction differently than you may view it as a shareholder.

These interests include:

- Certain officers and directors have stock options exercisable in full prior to the merger.
- James Mayer, President of Diablo Valley Bank, has entered into an employment agreement with Heritage Bank of Commerce and a noncompetition agreement with Heritage Commerce Corp and Heritage Bank of Commerce, both agreements becoming effective on the effective date of the merger. These agreements supersede Mr. Mayer's existing agreements with Diablo Valley Bank and eliminate his right to substantial payments from Diablo Valley Bank regarding this merger.
- John J. Hounslow, Chairman of the Board of Diablo Valley Bank, has entered into a consulting agreement with Heritage Bank of Commerce and a noncompetition agreement with Heritage Commerce Corp and Heritage Bank of Commerce, both agreements becoming effective on the effective date of the merger. These agreements will supersede Mr. Hounslow's existing agreements with Diablo Valley Bank and eliminate his right to receive substantial payments from Diablo Valley Bank regarding this merger on the effective date of the merger.
- John J. Hounslow and Mark E. Lefanowicz will be appointed to the Board of Directors of Heritage Commerce Corp and Heritage Bank of Commerce.
- Randall D. Greenfield, chief financial officer of Diablo Valley Bank, is a party to an employment agreement with Diablo Valley Bank that would result in substantial payments to him in the case the merger is completed and his employment with Heritage Bank of Commerce is terminated. The parties anticipate that Mr. Greenfield will not be hired by Heritage Bank of Commerce beyond an initial consulting period to assist in the transition and therefore he will receive the severance payments described in his agreement.

Diablo Valley Bank's Board of Directors was aware of these interests and took them into account in its decision to approve and adopt the merger agreement. For information concerning these interests, please see the discussion under the caption "Diablo Valley Bank's Directors and Officers Have Financial Interests in the Merger" on page [\*].

**Holders of Diablo Valley Bank Common Stock Have Appraisal Rights in the Merger (page [\*])**

Under California law, in the event the merger is completed, if you do not vote to approve and adopt the merger agreement, and you comply with the other requirements of the relevant provisions of California law described in this proxy statement/prospectus, you may elect to receive, in cash, the statutorily determined fair value of your shares of our common stock, with interest, in lieu of receiving the merger consideration. In order to qualify for dissenters' rights, a Diablo Valley Bank shareholder must vote against the merger and must make a written demand on Diablo Valley Bank within 30 days after Diablo Valley Bank mails the notice of approval of the merger to shareholders. A shareholder who executes and returns an unmarked proxy will have his or her shares voted "For" the merger and, as a consequence, such shareholder will be foreclosed from exercising rights as a dissenting shareholder.

If the merger is approved, Diablo Valley Bank will, within ten days after the meeting, mail to any shareholder who did not vote for the merger a notice that the required shareholder approval of the merger was obtained. This notice of approval will state the price determined by Diablo Valley Bank to represent the fair market value of any dissenting shares and a brief description of the procedures to be followed by dissenting shareholders who wish to further pursue their statutory rights. The dissenting shareholder must deliver his or her share certificate for receipt by Diablo Valley Bank within 30 days after the date on which the notice of approval was mailed to the shareholder.

The Diablo Valley Bank Board of Directors has determined that the fair market value of one share of Diablo Valley Bank common stock for this purpose is \$20.77. You may disagree with the Diablo Valley

Bank Board of Directors' determination of the fair market value. A copy of the full text of the relevant provisions of California law is attached as Appendix C, and any description in this proxy statement/prospectus of those provisions is qualified in its entirety by reference to Appendix C.

Diablo Valley Bank preferred shares, unless first converted to shares of common stock, will be redeemed for the redemption price of \$32.00 per share before completion of the merger. Under California law, if the dissenting shares are surrendered for conversion into shares of Diablo Valley Bank common stock or are transferred prior to the shareholders' delivery of such shares to Diablo Valley Bank, they lose their status as dissenting shares and the holders of such shares cease to be dissenting shareholders. The Diablo Valley Bank preferred shares that will be redeemed will be transferred to Diablo Valley Bank prior to the completion of the merger. As a result, the Diablo Valley Bank preferred shares, whether converted to shares of Diablo Valley Bank common stock or redeemed by Diablo Valley Bank, will lose their status as dissenting shares and, therefore, those shares will not be eligible for appraisal rights.

**Conditions That Must Be Satisfied or Waived for the Merger to Occur (page [\*])**

Currently, we expect to complete the merger in the second or third quarter of 2007. As more fully described in this document and in the merger agreement, the completion of the merger depends on a number of conditions being satisfied. These conditions include, among others, approval by Diablo Valley Bank shareholders, redemption of the Diablo Valley Bank series A preferred stock, absence of material adverse change in the parties, the receipt of all required regulatory approvals (such as approval by the Board of Governors of the Federal Reserve System and the California Department of Financial Institutions), the receipt of legal opinions by each company regarding the tax treatment of the merger and other customary conditions.

We cannot be certain when, or if, the conditions to the merger will be satisfied or waived, or that the merger will be completed.

**Termination of the Merger Agreement (page [\*])**

We may mutually agree to terminate the merger agreement before completing the merger, even after shareholder approval, as long as the termination is approved by each of our boards of directors. In addition, either of us may decide to terminate the merger agreement at any time, if:

- a final judicial or regulatory determination that any material provision of the merger agreement is unenforceable or denying a regulatory application;
- the Diablo Valley Bank shareholders fail to approve the adoption of the merger agreement by the required vote;
- the other party breaches any representation, warranty, covenant or agreement that gives rise to the failure of certain conditions precedent and fails to cure the breach within the agreed time;
- after September 30, 2007, if the merger has not been consummated by then, unless the failure to consummate the merger was due to the failure of the party requesting termination to perform an obligation under the merger agreement; or
- circumstances, in connection with the acceptance of a superior acquisition proposal by the Board of Directors of Diablo Valley Bank.

Heritage Commerce Corp may terminate the merger agreement if:

- Diablo Valley Bank's Board of Directors fails to provide notice or solicit proxies for the special meeting, fails to recommend the merger, changes or plans to change its positive recommendation of the merger, approves or recommends an acquisition proposal other than the merger, enters or plans

to enter into agreements for another acquisition proposal, or recommends that Diablo Valley Bank shareholders tender their shares in connection with an offer that is not made by Heritage Commerce Corp;

- Diablo Valley Bank breaches its obligations under the merger agreement with respect to the solicitation and consideration of offers other than the merger;
- Diablo Valley Bank exercises its rights with regard to the consideration of other acquisition proposals under the merger agreement and continues discussions with persons concerning an acquisition proposal for more than 15 business days after the date of such acquisition proposal; or
- the average closing price of Heritage Commerce Corp common stock for the 20 trading days ending on the fifth trading day immediately before the effective date of the merger is less than \$23.50.

Diablo Valley Bank may terminate the merger agreement if Diablo Valley Bank's Board of Directors authorizes Diablo Valley Bank, subject to complying with the terms of the merger agreement, to enter into a written agreement with respect to a superior acquisition proposal by a third party provided that:

- Diablo Valley Bank's Board of Directors complies with the provisions of the merger agreement relating to the non-solicitation of competing acquisition proposals and in responding to unsolicited acquisition proposals;
- before taking any action Diablo Valley Bank promptly gives Heritage Commerce Corp notice of its decision to take such action, the notice specifies the material terms and conditions of the superior acquisition proposal and identifies the person making such superior acquisition proposal, and Diablo Valley Bank gives Heritage Commerce Corp at least five business days to propose revisions to the merger agreement in response to the superior acquisition proposal and Diablo Valley Bank negotiates in good faith with Heritage Commerce Corp with respect to such proposed revisions;
- Diablo Valley Bank Board of Directors reasonably determines in good faith that it is necessary to terminate the merger agreement in order to comply with its fiduciary duties under applicable law; and
- Diablo Valley Bank pays a termination fee to Heritage Commerce Corp as described below.

**Termination Fee if the Merger is Not Completed (page [\*])**

Diablo Valley Bank is required to pay Heritage Commerce Corp a termination fee of \$3,380,000 under the following circumstances:

- if Heritage Commerce Corp terminates the merger agreement because Diablo Valley Bank's Board of Directors fails to recommend the merger, adversely alters or modifies its favorable recommendation, approves or recommends an acquisition proposal other than the merger, enters or plans to enter into agreements for another acquisition proposal, or recommends that Diablo Valley Bank shareholders tender their shares in connection with an offer that is not made by Heritage Commerce Corp;
- if Heritage Commerce Corp terminates its merger agreement because Diablo Valley Bank breaches its obligations under the merger agreement with respect to the solicitation and consideration of offers other than the merger;
- if Diablo Valley Bank terminates the merger agreement in connection with the acceptance of a superior acquisition proposal by the Diablo Valley Bank's Board of Directors that is deemed necessary to fulfill its fiduciary duties as discussed above; or





- if there is a publicly known acquisition proposal other than the merger, and the merger agreement is later terminated because of Diablo Valley Bank shareholders' failure to approve the merger or because the merger is not consummated in time because of Diablo Valley Bank's actions, and Diablo Valley Bank completes an acquisition proposal within 12 months after termination of the merger agreement, or within 6 months of the termination of the merger agreement, enters into an agreement for an acquisition proposal.

**Regulatory Approvals Required for the Merger (page [\*])**

Diablo Valley Bank and Heritage Commerce Corp have agreed to use their reasonable best efforts to obtain all regulatory approvals required to complete the transactions contemplated by the merger agreement. These approvals include approval from the Federal Reserve Board and the California Department of Financial Institutions. Heritage Commerce Corp and Diablo Valley Bank have completed, or will complete, the filing of applications and notifications to obtain the required regulatory approvals.

Although we do not know of any reason why we cannot obtain these regulatory approvals in a timely manner, we cannot be certain when or if we will obtain them.

**The Rights of Diablo Valley Bank Shareholders will be Governed by California Law and the Heritage Commerce Corp Articles of Incorporation and Bylaws after the Merger (page [\*])**

The legal rights of Diablo Valley Bank shareholders who become Heritage Commerce Corp shareholders will change as a result of the merger because the rights of the holders of Heritage Commerce Corp common stock will be governed by the Heritage Commerce Corp articles of incorporation and bylaws. The differences in the rights that Diablo Valley Bank shareholders will have as a result of the merger are discussed beginning on page [\*].

**Diablo Valley Bank will Hold its Special Meeting on [\*] (page [\*])**

The special meeting will be held on [\*] at 5:30 p.m., local time, at 387 Diablo Road, Danville, California 94526. At the special meeting, Diablo Valley Bank shareholders will be asked to:

- approve the merger; and
- approve the adjournment of the special meeting, if necessary, to solicit additional proxies, in the event that there are not sufficient votes at the time of the special meeting to approve the merger.

*Record Date.* Only holders of record of Diablo Valley Bank common stock and series A preferred stock at the close of business on [\*] will be entitled to vote at the special meeting. Each share of Diablo Valley Bank common stock is entitled to one vote. Each holder of series A preferred stock is entitled to one vote, voting as a separate class from the common stock holders. As of the record date of [\*], there were [\*] shares of Diablo Valley Bank common stock and [\*] shares of Diablo Valley series A preferred stock entitled to vote at the special meeting.

*Required Vote.* To approve the merger, the holders of a majority of the outstanding shares of Diablo Valley Bank common stock and the outstanding shares of the series A preferred stock, each voting as a separate class, must vote in favor of approving the merger. Because approval is based on the affirmative vote of at least a majority of shares outstanding of each of the common stock and preferred stock, a Diablo Valley Bank shareholder's failure to vote or an abstention will have the same effect as a vote against the merger.

Approval of any necessary adjournment of the special meeting may be obtained by the affirmative vote of the holders of a majority of the shares of the common stock present in person or by proxy, even if



less than a quorum. Because approval of such adjournment is based on the affirmative vote of a majority of shares present in person or by proxy, abstentions will have the same effect as a vote against this proposal.

As of the record date, Diablo Valley Bank directors and executive officers and their affiliates had the right to vote 436,680 shares of Diablo Valley Bank common stock, or approximately 17% of the outstanding common shares (excluding exercisable options and shares of preferred stock convertible to common stock) and 40,122 shares of series A preferred stock, or approximately 19% of the outstanding preferred shares. As described below, the directors of Diablo Valley Bank have agreed to vote their shares of Diablo Valley Bank common stock in favor of the merger.

**Diablo Valley Bank's Directors Have Agreed to Vote in Favor of the Merger (page [\*])**

In consideration of Heritage Commerce Corp agreeing to enter into the merger agreement, each of the members of our Board of Directors entered into voting agreements with Heritage Commerce Corp under which they agreed to vote their shares of Diablo Valley Bank common stock in favor of the merger agreement and against any competing acquisition transaction. The shares subject to these voting agreements represent approximately 17% (28% inclusive of exercisable options and shares of preferred stock convertible to common stock) of the outstanding shares of Diablo Valley Bank common stock and 19% of the series A preferred stock as of the record date. A form of the voting agreement is attached to this proxy statement/prospectus as Appendix D.

**SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA OF HERITAGE COMMERCE CORP**

Set forth below are highlights derived from Heritage Commerce Corp's audited consolidated financial data as of and for the years ended December 31, 2002 through 2006. You should read this information in conjunction with Heritage Commerce Corp's consolidated financial statements and related notes included in Heritage Commerce Corp's Annual Report on Form 10-K for the year ended December 31, 2006, which is incorporated by reference in this document and from which this information is derived. See "Where You Can Find More Information" on page [\*].

	<b>AT AND FOR YEAR ENDED DECEMBER 31,</b>					
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	
	<b>(Dollars in thousands, except share and per share amounts and ratios)</b>					
<b>INCOME STATEMENT DATA:</b>						
Interest income	\$ 72,957	\$ 63,756	\$ 50,685	\$ 46,447	\$ 51,015	
Interest expense	22,525	15,907	9,648	10,003	15,237	
Net interest income before provision for loan losses	50,432	47,849	41,037	36,444	35,778	
Provision for loan losses	(503)	313	666	2,900	2,663	
Net interest income after provision for loan losses	50,935	47,536	40,371	33,544	33,115	
Noninterest income	9,840	9,423	10,544	10,812	9,684	
Noninterest expense	34,268	35,233	39,238	33,084	32,161	
Income before income taxes	26,507	21,726	11,677	11,272	10,638	
Income tax expense	9,237	7,280	3,199	3,496	3,484	
Net income	\$ 17,270	\$ 14,446	\$ 8,478	\$ 7,776	\$ 7,154	
<b>PER SHARE DATA:</b>						
Basic net income(1)	\$ 1.47	\$ 1.22	\$ 0.73	\$ 0.69	\$ 0.65	
Diluted net income(2)	\$ 1.44	\$ 1.19	\$ 0.71	\$ 0.67	\$ 0.63	
Book value(3)	\$ 10.54	\$ 9.45	\$ 8.45	\$ 7.86	\$ 7.30	
Weighted average number of shares outstanding basic	11,725,671	11,795,635	11,559,155	11,221,232	11,063,965	
Weighted average number of shares outstanding diluted	11,956,433	12,107,230	11,986,856	11,572,588	11,324,650	
Shares outstanding at period end	11,656,943	11,807,649	11,669,837	11,381,037	11,214,414	
<b>BALANCE SHEET DATA:</b>						
Securities	\$ 172,298	\$ 198,495	\$ 232,809	\$ 153,473	\$ 126,443	
Net loans	\$ 716,475	\$ 678,554	\$ 713,033	\$ 648,706	\$ 660,680	
Allowance for loan losses	\$ 9,279	\$ 10,224	\$ 12,497	\$ 13,451	\$ 13,227	
Total assets	\$ 1,037,138	\$ 1,130,509	\$ 1,108,173	\$ 1,005,982	\$ 960,066	
Total deposits	\$ 846,593	\$ 939,759	\$ 918,535	\$ 835,410	\$ 841,936	
Other borrowed funds	\$ 21,800	\$ 32,700	\$ 47,800	\$ 43,600	\$ 0	
Notes payable to subsidiary grantor trusts	\$ 23,702	\$ 23,702	\$ 23,702	\$ 23,702	\$ 23,000	
Total shareholders' equity	\$ 122,820	\$ 111,617	\$ 98,579	\$ 89,485	\$ 81,862	
<b>SELECTED PERFORMANCE RATIOS:</b>						
Return on average assets(4)	1.57	% 1.27	% 0.80	% 0.81	% 0.77	%
Return on average equity	14.62	% 13.73	% 9.04	% 9.04	% 9.15	%
Net interest margin	5.06	% 4.58	% 4.22	% 4.15	% 4.19	%
Efficiency	56.86	% 61.52	% 76.07	% 70.01	% 70.74	%
Average net loans as a percentage of average deposits	77.61	% 73.55	% 77.11	% 77.21	% 76.49	%
Average total shareholders' equity as a percentage of average total assets	10.75	% 9.25	% 8.80	% 8.95	% 8.41	%
<b>SELECTED ASSET QUALITY RATIOS:</b>						
Net loan charge-offs to average loans	0.06	% 0.28	% 0.19	% 0.41	% 0.09	%
Allowance for loan losses to total loans	1.28	% 1.48	% 1.72	% 2.03	% 1.96	%
<b>CAPITAL RATIOS:</b>						
Tier 1 risk-based	17.3	% 14.2	% 13.0	% 13.3	% 12.1	%
Total risk-based	18.4	% 15.3	% 14.3	% 14.5	% 13.3	%
Leverage	13.6	% 11.6	% 10.9	% 11.1	% 10.7	%

- (1) Represents net income divided by the average number of shares of common stock outstanding for the respective period.
- (2) Represents net income divided by the average number of shares of common stock and common stock-equivalents outstanding for the respective period.
- (3) Represents shareholders' equity divided by the number of shares of common stock outstanding at the end of the period indicated.
- (4) Average balances used in this table are based on daily averages.



**SELECTED HISTORICAL FINANCIAL DATA OF DIABLO VALLEY BANK**

Diablo Valley Bank commenced operations on October 20, 2003. Set forth below are highlights derived from Diablo Valley Bank's audited financial statements as of and for the years ended December 31, 2003 through 2006.

	2006	2005	2004	2003*	
	(Dollars in thousands, except per share amounts and ratios)				
<b>INCOME STATEMENT DATA:</b>					
Interest income	\$ 15,559	\$ 9,551	\$ 3,211	\$ 82	
Interest expense	5,222	2,233	705	33	
Net interest income before provision for loan losses	10,337	7,318	2,506	49	
Provision for loan losses	464	1,175	680	70	
Net interest income after provision for loan losses	9,873	6,143	1,826	(21 )	
Noninterest income	200	86	33	3	
Noninterest expense	6,446	4,754	3,960	685	
Income (loss) before income taxes	3,627	1,475	(2,101 )	(703 )	
Income tax expense (benefit)	1,620	(878 )	1		
Net income (loss)	\$ 2,007	\$ 2,353	\$ (2,102 )	\$ (703 )	
<b>PER SHARE DATA:</b>					
Basic net income (loss)	\$ 0.67	\$ 0.88	\$ (0.85 )	\$ (0.28 )	
Diluted net income	\$ 0.62	\$ 0.80			
Book value	\$ 7.01	\$ 6.14	\$ 5.23	\$ 6.11	
Weighted average number of shares outstanding basic	2,491,488	2,480,320	2,475,293	2,475,000	
Weighted average number of shares outstanding diluted	2,721,758	2,749,927			
Shares outstanding at period end	2,502,146	2,482,946	2,476,496	2,474,996	
<b>BALANCE SHEET DATA:</b>					
Securities	\$ 8,734	\$ 14,616	\$ 13,683	\$ 3,023	
Net loans	\$ 197,023	\$ 144,143	\$ 92,336	\$ 6,918	
Allowance for loan losses	\$ 2,389	\$ 1,925	\$ 750	\$ 70	
Total assets	\$ 249,228	\$ 192,692	\$ 126,219	\$ 41,482	
Total deposits	\$ 224,215	\$ 165,537	\$ 108,054	\$ 26,339	
Other borrowed funds	\$ 5,000	\$ 5,000	\$ 5,000	\$	
Total shareholders' equity	\$ 24,064	\$ 21,749	\$ 12,956	\$ 15,130	
<b>SELECTED PERFORMANCE RATIOS:</b>					
Return on average assets	0.92	% 1.44	% -2.42	% -12.04	%
Return on average equity	8.73	% 13.88	% -15.23	% -22.48	%
Net interest margin	4.99	% 4.73	% 3.20	% 1.00	%
Efficiency	61.2	% 64.2	% 156.0	% 1317.3	%
Average net loans as a percentage of average deposits	87.7	% 81.5	% 64.7	% 21.8	%
Average shareholders' equity as a percent of average total assets	10.5	% 10.3	% 15.9	% 53.6	%
<b>SELECTED ASSET QUALITY RATIOS:</b>					
Net loan charge-offs to average loans	0.00	% 0.00	% 0.00	% 0.00	%
Allowance for loan losses to total loans	1.20	% 1.32	% 0.81	% 1.00	%
<b>CAPITAL RATIOS:</b>					
Tier 1 risk-based	10.6	% 13.1	% 11.3	% 110.8	%
Total risk-based	11.6	% 14.3	% 11.9	% 111.3	%
Leverage	9.7	% 11.4	% 11.2	% 65.3	%

\* Operations commenced October 20, 2003

**SELECTED UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION**

The accompanying selected unaudited pro forma condensed combined statement of income data presents the Heritage Commerce Corp audited consolidated statement of income data for the year ended December 31, 2006 combined with Diablo Valley Bank's audited statement of income data for the year ended December 31, 2006. The selected unaudited pro forma condensed combined statement of income data gives effect to the merger as if it had occurred at the beginning of 2006. The accompanying selected unaudited pro forma condensed combined balance sheet assumes the merger took place as of December 31, 2006. The selected unaudited pro forma condensed combined balance sheet data combines the audited consolidated balance sheet data of Heritage Commerce Corp as of December 31, 2006 and the audited balance sheet data of Diablo Valley Bank as of December 31, 2006.

The selected unaudited pro forma condensed combined financial information includes purchase accounting adjustments to record the assets and liabilities of Diablo Valley Bank at their estimated fair values and is subject to further adjustments as additional information becomes available and as additional analyses are performed. The selected unaudited pro forma condensed combined financial information presented below should be read together with the historical financial statements of Heritage Commerce Corp and Diablo Valley Bank, including the related notes and the other unaudited pro forma financial information, including the related notes, contained in this document or incorporated by reference. See

Unaudited Pro Forma Condensed Combined Financial Statements beginning on page [\*]. The selected unaudited pro forma condensed combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined company had the impact of business integration costs and possible revenue enhancements and expense efficiencies, among other factors, been considered.

The pro forma financial information assumes that the Diablo Valley Bank common stock will be exchanged for 1,732,298 shares of Heritage Commerce Corp common stock and \$15,012,876 of cash; however, the actual amount of cash paid may differ from this assumption. For purposes of illustration, the selected unaudited pro forma condensed combined figures have been calculated assuming that the average closing price of Heritage Commerce Corp common stock is \$26.27 (the average closing price for 20 trading days ending on the fifth trading day immediately before March 9, 2007) resulting in value to Diablo Valley Bank shareholders of \$24.19 per share consideration. We anticipate that the merger will provide the combined company with financial benefits that include reduced operating expenses and revenue enhancement opportunities. The selected unaudited pro forma condensed combined financial information does not reflect the impact of possible revenue enhancements, expense efficiencies, asset dispositions and share repurchases, among other factors, that may result as a consequence of the merger and, accordingly, does not attempt to predict or suggest future results. It also does not necessarily reflect what the historical results of the combined company would have been had our companies been combined during this period. Upon completion of the merger, the operating results of Diablo Valley Bank will be reflected in the consolidated financial statements of Heritage Commerce Corp on a prospective basis.



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As of and for the Year Ended December 31, 2006				
	Heritage Commerce Corp (Dollars in Thousands)	Diablo Valley Bank	Adjustments	Pro Forma Combined
<b>Summary Statement of Income Data:</b>				
Interest income	\$ 72,957	\$ 15,559	\$ (1,199 )	\$ 87,317
Interest expense	22,525	5,222	158	27,905
Net interest income before provision for loan losses	50,432	10,337	(1,357 )	59,412
Provision for loan losses	(503 )	464		(39 )
Net interest income after provision for loan losses	50,935	9,873	(1,357 )	59,451
Noninterest income	9,480	200		10,040
Noninterest expense	34,268	6,446	761	41,475
Income before income taxes	26,507	3,627	(2,118 )	28,016
Income tax expense	9,237	1,620	(890 )	9,967
Net income	\$ 17,270	\$ 2,007	\$ (1,228 )	\$ 18,049
<b>Summary Balance Sheet Data:</b>				
Cash and cash equivalents	\$ 49,385	\$ 33,513	\$ (30,161 )	\$ 52,737
Securities	172,298	8,735	(65 )	180,968
Net loans	716,475	197,023	(349 )	913,149
Total assets	1,037,138	249,228	22,421	1,308,787
Deposits	846,593	224,215	(157 )	1,070,651
Total liabilities	914,318	225,164	978	1,140,460
Total shareholders equity	122,820	24,064	21,443	168,327

**Comparative Unaudited Per Share Data**

	Historical Heritage Commerce Corp	Diablo Valley Bank	Pro Forma Combined	Per Diablo Valley Bank Equivalent Share(1)
Net income per common share for the year ended December 31, 2006				
Basic	\$ 1.47	\$ 0.67	\$ 1.34	\$ 1.24
Diluted	\$ 1.44	\$ 0.62	\$ 1.32	\$ 1.22
Cash dividends				
For the year ended December 31, 2006	\$ 0.20	\$	\$ 0.20	\$ 0.18
Book value per common share				
As of December 31, 2006	\$ 10.54	\$ 7.01	\$ 12.57	\$ 11.57

(1) Per Diablo Valley Bank equivalent pro forma is calculated by multiplying pro forma combined by the hypothetical exchange ratio of .9208.

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

This document contains or incorporates by reference a number of forward-looking statements, including statements about the financial conditions, results of operations, earnings outlook and prospects of Heritage Commerce Corp, Diablo Valley Bank and the potential combined company and may include statements for the period following the completion of the merger. Forward-looking statements are typically identified by words such as plan, believe, expect, anticipate, intend, outlook, estimate, forecast, project and other similar words and expressions.

The forward-looking statements involve certain risks and uncertainties. The ability of either Heritage Commerce Corp or Diablo Valley Bank to predict results or the actual effects of its plans and strategies, or those of the combined company, is subject to inherent uncertainty. Factors that may cause actual results or earnings to differ materially from such forward-looking statements include those set forth below under Risk Factors, as well as, among others, the following:

- those discussed and identified in public filings with the SEC made by Heritage Commerce Corp;
- completion of the merger is dependent on, among other things, receipt of shareholder and regulatory approvals, the timing of which cannot be predicted with precision and which may not be received at all;
- the merger may be more expensive to complete than anticipated, including as a result of unexpected factors or events;
- the integration of Diablo Valley Bank's business and operations with those of Heritage Commerce Corp may take longer than anticipated, may be more costly than anticipated and may have unanticipated adverse results relating to Diablo Valley Bank's or Heritage Commerce Corp's existing businesses; and
- the anticipated cost savings and other synergies of the merger may take longer to be realized or may not be achieved in their entirety, and attrition in key client, partner and other relationships relating to the merger may be greater than expected.

Because these forward-looking statements are subject to assumptions and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements. You are cautioned not to place undue reliance on these statements, which speak only as of the date of this document or the date of any document incorporated by reference in this document.

All subsequent written and oral forward-looking statements concerning the merger or other matters addressed in this document and attributable to Heritage Commerce Corp or Diablo Valley Bank or any person acting on their behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this document. Except to the extent required by applicable law or regulation, Heritage Commerce Corp and Diablo Valley Bank undertake no obligation to update these forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.

## RISK FACTORS

*In addition to general investment risks and the other information contained in or incorporated by reference into this document, including the matters under the caption *Cautionary Statement Regarding Forward-Looking Statements* and the matters discussed under the caption *Risk Factors* included in the Annual Report on Form 10-K filed by Heritage Commerce Corp for the year ended December 31, 2006 as updated by subsequently filed Forms 10-Q and 10-K, you should carefully consider the following factors in deciding whether to vote for adoption of the merger agreement.*

### **Because the Market Price of Heritage Commerce Corp Common Stock Will Fluctuate, Diablo Valley Bank Shareholders Cannot Be Sure of the Trading Price of the Merger Consideration They Will Receive.**

The merger agreement is designed to ensure that a certain percentage of the total consideration that will be paid to Diablo Valley Bank shareholders in the merger will be paid in Heritage Commerce Corp common stock and the balance in cash. Upon completion of the merger, outstanding shares of Diablo Valley Bank common stock will be converted into Heritage Commerce Corp common stock or cash based on the formula described in this document. The exchange ratio, and the market value of the stock portion of the merger consideration implied by that exchange ratio, may vary from the closing price of Heritage Commerce Corp common stock on the date we announced the merger, on the date we mailed this document to Diablo Valley Bank shareholders, on the date of the special meeting of the Diablo Valley Bank shareholders and thereafter. Changes in the market value of Heritage Commerce Corp common stock prior to completion of the merger will affect the implied value of the merger consideration that Diablo Valley Bank shareholders will receive upon completion of the merger. Accordingly, at the time of the special meeting, Diablo Valley Bank shareholders will not know or be able to calculate the actual market value of the merger consideration they would receive upon completion of the merger. Heritage Commerce Corp is permitted to terminate the merger agreement if the market price of its common stock averaged over the 20 trading days ending the fifth trading day immediately before the effective date of the merger is below \$23.50. Stock price changes may result from a variety of factors, including general market and economic conditions, changes in our respective businesses, operations and prospects, and regulatory considerations. Many of these factors are beyond our control. You should obtain current market quotations for shares of Heritage Commerce Corp common stock and for shares of Diablo Valley Bank common stock.

### **We May Fail To Realize All of the Anticipated Benefits of the Merger.**

The success of the merger will depend, in part, on our ability to realize the anticipated benefits and cost savings from combining the businesses of Heritage Commerce Corp and Diablo Valley Bank. However, to realize these anticipated benefits and cost savings, we must successfully combine the businesses of Heritage Commerce Corp and Diablo Valley Bank. If we are not able to achieve these objectives, the anticipated benefits and cost savings of the merger may not be realized fully or at all or may take longer to realize than expected.

Heritage Commerce Corp and Diablo Valley Bank have operated and, until the completion of the merger, will continue to operate, independently. It is possible that the integration process could result in the loss of key employees, the disruption of each bank's ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients, customers, depositors and employees or to achieve the anticipated benefits of the merger. Integration efforts between the two companies will also divert management attention and resources. These integration matters could have an adverse effect on each of Diablo Valley Bank and Heritage Commerce Corp during the transition period.

**The Market Price of Heritage Commerce Corp Common Stock after the Merger May Be Affected by Factors Different from Those Currently Affecting the Shares of Diablo Valley Bank or Heritage Commerce Corp.**

The businesses of Heritage Commerce Corp and Diablo Valley Bank differ and, accordingly, the results of operations of the combined company and the market price of the combined company's shares of common stock may be affected by factors different from those currently affecting the independent results of operations of Diablo Valley Bank. For a discussion of the businesses of Heritage Commerce Corp and Diablo Valley Bank and of certain factors to consider in connection with those businesses, see the descriptions of Heritage Commerce Corp and Diablo Valley Bank included in this document and information regarding Heritage Commerce Corp included in other documents that are incorporated by reference in this document and referred to under "Where You Can Find More Information."

**The Merger Agreement Limits Diablo Valley Bank's Ability to Pursue Alternatives to the Merger.**

The merger agreement contains no shop provisions that, subject to specified exceptions, limit Diablo Valley Bank's ability to discuss, facilitate or commit to competing third-party proposals to acquire all or a significant part of Diablo Valley Bank, as well as a termination fee that is payable by Diablo Valley Bank under certain circumstances. These provisions might discourage a potential competing acquiror that might have an interest in acquiring all or a significant part of Diablo Valley Bank from considering or proposing that acquisition even if it were prepared to pay consideration with a higher per share market price than that proposed in the merger, or might result in a potential competing acquiror proposing to pay a lower per share price to acquire Diablo Valley Bank than it might otherwise have proposed to pay.

**The Voting Agreements Limit Diablo Valley Bank's Ability to Pursue Alternatives to the Merger.**

The merger agreement must be approved by the holders of a majority of the outstanding shares of Diablo Valley Bank common stock entitled to vote at the special meeting. The members of the Board of Directors of Diablo Valley Bank, who in the aggregate have the power to vote approximately 17% of the outstanding shares of Diablo Valley Bank common stock, have each executed voting agreements with Heritage Commerce Corp pursuant to which they have agreed to vote their shares of Diablo Valley Bank common stock in favor of the merger and against any competing business combination transaction.

**The Merger Is Subject to a Separate Class Vote by the Holders of the Diablo Valley Bank Series A Preferred Stock.**

The merger agreement must be approved by the holders of a majority of the outstanding shares of Diablo Valley Bank series A preferred stock. The holders of the series A preferred stock vote as a separate class from the holders of common stock. As a result, for example, a majority of the common stock may be voted in favor of the merger, but if a majority of the series A preferred shares are voted against the merger, the merger will not go forward.

**The Merger Is Subject to the Receipt of Consents and Approvals from Government Entities that May Impose Conditions that Could Have an Adverse Effect on Heritage Commerce Corp.**

Before the merger may be completed, various approvals or consents must be obtained from the Federal Reserve Board and the California Department of Financial Institutions. These governmental entities may impose conditions on the completion of the merger or require changes to the terms of the merger. Although Heritage Commerce Corp and Diablo Valley Bank do not currently expect that any such conditions or changes will be imposed, there can be no assurance that they will not be, and such conditions or changes could have the effect of delaying completion of the merger or imposing additional costs on or limiting the revenues of Heritage Commerce Corp following the merger, any of which might have an adverse effect on Heritage Commerce Corp following the merger. Heritage Commerce Corp is not

obligated to complete the merger if the regulatory approvals received in connection with the completion of the merger in its reasonable opinion include any conditions or restrictions that, in the aggregate, would be expected to have a material adverse effect on Heritage Commerce Corp or otherwise are burdensome to Heritage Commerce Corp.

**Diablo Valley Bank Shareholders May Receive Merger Consideration that Is Inconsistent with their Elections.**

Although Diablo Valley Bank shareholders will be able to elect to receive cash or Heritage Commerce Corp common stock for each of their shares of Diablo Valley Bank common stock, the merger agreement provides that a certain percentage of the total consideration to be paid to Diablo Valley Bank shareholders in the merger will be paid in Heritage Commerce Corp common stock and the balance in cash. Your election, therefore, may be proportionately reduced if the total stock or cash elections exceed these limitations. In that circumstance, you will receive a combination of cash and Heritage Commerce Corp common stock following a pro rata adjustment of all elections for Heritage Commerce Corp common stock in order to keep within these limitations.

For a more detailed description of the merger consideration, see *Merger Consideration* beginning on page [\*].

**Diablo Valley Bank Shareholders Will Have Less Influence as Shareholders of Heritage Commerce Corp than as Shareholders of Diablo Valley Bank.**

Diablo Valley Bank's shareholders currently have the right to vote in the election of the Board of Directors of Diablo Valley Bank and on other matters affecting Diablo Valley Bank. When the merger occurs, each Diablo Valley Bank shareholder that receives shares of Heritage Commerce Corp common stock will become a shareholder of Heritage Commerce Corp with a percentage ownership of the combined organization that is much smaller than the shareholder's percentage ownership of Diablo Valley Bank. In fact, it is expected that the former shareholders of Diablo Valley Bank as a group will own less than 13% of the outstanding shares of Heritage Commerce Corp immediately after the merger. Because of this, Diablo Valley Bank's shareholders will have less influence on the management and policies of Heritage Commerce Corp than they now have on the management and policies of Diablo Valley Bank.

**Diablo Valley Bank Executive Officers and Directors Have Interests in the Merger that May be Different from, or in Addition to, the Interests of Diablo Valley Bank Shareholders.**

Diablo Valley Bank's officers and directors have interests in the merger that may be different from, or in addition to, the interests of Diablo Valley Bank shareholders. For example, certain executive officers and employees of Diablo Valley Bank may receive payments with respect to outstanding stock options that will be cashed out in the merger. Additionally, certain members of Diablo Valley Bank's executive management team have agreed to new employment and consulting and non-competition agreements with Heritage Commerce Corp. Diablo Valley Bank's Board of Directors was aware of these interests and took them into account in its decision to approve and adopt the merger agreement. For information concerning these interests, please see the discussion under the caption *Diablo Valley Bank's Directors and Officers Have Financial Interests in the Merger*.

**The Combined Loan Portfolios May Not Perform as Expected.**

Heritage Commerce Corp's performance and prospects after the merger will be dependent to a significant extent on the performance of the combined loan portfolios of Heritage Bank of Commerce and Diablo Valley Bank, and ultimately, on the financial condition of their respective borrowers and other customers. The existing loan portfolios of the two banks differ to some extent in the types of borrowers,

industries and credits represented. In addition, there are differences in the documentation, classifications, credit ratings and management of the portfolios. As a result, Heritage Bank of Commerce and Diablo Valley Bank's combined loan portfolio after the merger may have a different risk profile than the loan portfolio of either Diablo Valley Bank or Heritage Bank of Commerce before the merger. The performance of the two loan portfolios will be adversely affected if any such factor is worse than currently anticipated. In addition, to the extent that present customers of Diablo Valley Bank are not retained by Heritage Bank of Commerce or additional expenses are incurred in retaining them, there could be adverse effects on future consolidated results of operation of Heritage Bank of Commerce following the merger. Realization of improvement in profitability is dependent, in part, on the extent to which the revenues of Diablo Valley Bank are maintained and enhanced.

**Heritage Commerce Corp May Engage in Further Expansion Through New Branch Openings or Acquisitions, which Could Adversely Affect Net Income.**

Heritage Commerce Corp may engage in further expansion. There are risks associated with expansion and, in particular, expansion through acquisitions. These risks include, among others, incorrectly assessing the asset quality of a bank acquired in a particular acquisition, encountering greater than anticipated costs of opening new branches or incorporating acquired businesses, facing resistance from customers or employees, and being unable to profitably deploy assets acquired through expansion or in acquisitions. To the extent Heritage Commerce Corp issues capital stock in connection with additional acquisitions, these acquisitions and related stock issuances may have a dilutive effect on earnings per share and share ownership.

## THE DIABLO VALLEY BANK SPECIAL MEETING

This section contains information about the special meeting of Diablo Valley Bank shareholders that has been called to consider and approve the merger of Diablo Valley Bank with and into Heritage Bank of Commerce, with Heritage Bank of Commerce as the surviving corporation in the merger.

Together with this document, we are also sending you a notice of the special meeting and a form of proxy that is solicited by the Diablo Valley Bank Board of Directors. The special meeting will be held on [ \* ], 2007, at 5:30 p.m. local time, at 387 Diablo Road, Danville, California 94526, subject to any adjournments or postponements.

### Matters to Be Considered

The purpose of the special meeting is to vote on a proposal for approval of the merger.

You also will be asked to vote on a proposal to approve the adjournment of the special meeting, if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the merger.

### Proxies

Each copy of this document mailed to holders of Diablo Valley Bank common stock and series A preferred stock is accompanied by a form of proxy with instructions for voting. If you hold stock in your name as a shareholder of record, you should complete and return the proxy card accompanying this document in the enclosed **WHITE** envelope (or vote by telephone or internet in accordance with instructions on the enclosed proxy card) to ensure that your vote is counted at the special meeting, or at any adjournment or postponement of the special meeting, regardless of whether you plan to attend the special meeting.

If you hold your stock in street name through a bank or broker, you must direct your bank or broker to vote in accordance with the instructions you have received from your bank or broker.

If you hold stock in your name as a shareholder of record, you may revoke any proxy at any time before it is voted by (1) signing and returning a proxy card with a later date, (2) delivering a written revocation letter to Diablo Valley Bank's Secretary or (3) attending the special meeting in person, notifying the Secretary, and voting by ballot at the special meeting. If you hold your stock in street name through a bank or broker, you must follow your bank's or broker's instructions to revoke your proxy.

Any shareholder entitled to vote in person at the special meeting may vote in person regardless of whether a proxy has been previously given, and such vote will revoke any previous proxy but the mere presence (without notifying Diablo Valley Bank's Secretary) of a shareholder at the special meeting will not constitute revocation of a previously given proxy.

Written notices of revocation and other communications about revoking your proxy should be addressed to:

Diablo Valley Bank  
387 Diablo Road  
Danville, California 94526  
Attention: Secretary

All shares represented by valid proxies that we receive through this solicitation, and that are not revoked, will be voted in accordance with your instructions on the proxy card. If you make no specification on your proxy card as to how you want your shares voted before signing and returning it, your proxy will be voted **FOR** approval of the merger and **FOR** approval of the proposal to adjourn the special meeting,

if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the merger. According to the Diablo Valley Bank bylaws, business to be conducted at a special meeting of shareholders may only be brought before the meeting by means of Diablo Valley Bank's notice of the meeting. Accordingly, no matters other than the matters described in this document will be presented for action at the special meeting or at any adjournment or postponement of the special meeting.

#### **Election Form and Transmittal Materials**

Diablo Valley Bank common stock shareholders should also complete, mail and enclose in the **BLUE** envelope the election form and transmittal materials accompanying this proxy statement/prospectus with their common stock certificates to the exchange agent. If you do not wish to make an election, you will receive separate instructions for submitting your Diablo Valley Bank common stock certificates in exchange for the merger consideration following completion of the merger.  *Holders of Diablo Valley Bank series A preferred shares will receive separate transmittal instructions related to the redemption of their shares of series A preferred stock by Diablo Valley Bank.*

#### **Solicitation of Proxies**

Diablo Valley Bank will bear the entire cost of soliciting proxies from you (other than the costs of printing and mailing the proxy materials, which will be borne by Heritage Commerce Corp). In addition to solicitation of proxies by mail, Diablo Valley Bank will request that banks, brokers and other record holders send proxies and proxy material to the beneficial owners of Diablo Valley Bank common stock and secure their voting instructions. Diablo Valley Bank will reimburse the record holders for their reasonable expenses in taking those actions. Diablo Valley Bank may use its regular employees, who will not be specially compensated, to solicit proxies from Diablo Valley Bank shareholders, either personally or by telephone, facsimile, letter or other electronic means.

#### **Record Date**

The close of business on [\*] has been fixed as the record date for determining the Diablo Valley Bank shareholders entitled to receive notice of and to vote at the special meeting. At that time, 2,505,146 shares of Diablo Valley Bank common stock were outstanding, held by approximately 156 holders of record, and 207,061 shares of Diablo Valley Bank series A preferred stock were outstanding, held by approximately 80 holders of record.

#### **Voting Rights and Vote Required**

The presence, in person or by properly executed proxy, of the holders of a majority of the outstanding shares of Diablo Valley Bank common stock and a majority of the outstanding shares of series A preferred stock entitled to vote is necessary to constitute a quorum at the special meeting. Abstentions will be counted for the purpose of determining whether a quorum is present.

Approval of the merger requires the affirmative vote of the holders of at least a majority of the outstanding shares of Diablo Valley Bank common stock and series A preferred stock entitled to vote at the special meeting, voting as separate classes. You are entitled to one vote for each share of Diablo Valley Bank common stock or series A preferred stock you held as of the record date. The failure to vote by proxy or in person will have the same effect as a vote against the merger.

Approval of any proposal to adjourn or postpone the meeting, if necessary, for the purpose of soliciting additional proxies may be obtained by the affirmative vote of the holders of a majority of the shares present in person or by proxy, even if less than a quorum. Because approval of such adjournments is



based on the affirmative vote of a majority of shares present in person or by proxy, abstentions will have the same effect as a vote against this proposal.

The Diablo Valley Bank Board of Directors urges you to promptly vote by completing, dating and signing the accompanying proxy card and to return it promptly in the enclosed postage-paid envelope or, if you hold your stock in street name through a bank or broker, by following the voting instructions of your bank or broker.

As of the record date, directors and executive officers of Diablo Valley Bank and their affiliates, had the right to vote 436,680 shares of Diablo Valley Bank common stock, or approximately 17% of the outstanding Diablo Valley Bank common stock (exclusive of exercisable options and shares of preferred stock convertible to common stock) and 40,122 shares of series A preferred stock or approximately 19%, of the outstanding series A preferred stock at that date. The directors have agreed to vote their shares of Diablo Valley Bank common stock, in favor of the proposals to be presented at the special meeting.

#### **Recommendation of the Diablo Valley Bank Board of Directors**

The Diablo Valley Bank Board of Directors has approved the merger agreement and the transactions it contemplates, including the merger. The Diablo Valley Bank Board of Directors determined that the merger, merger agreement and the transactions contemplated by the merger agreement are advisable and in the best interests of Diablo Valley Bank and its shareholders and recommends that you vote FOR approval of the merger and FOR authority to vote for adjournment or postponement of the meeting for the purpose of soliciting additional proxies. See The Merger Diablo Valley Bank's Reasons for the Merger; Recommendation of the Diablo Valley Bank Board of Directors for a more detailed discussion of the Diablo Valley Bank Board of Directors' recommendation.

#### **Attending the Meeting**

All holders of Diablo Valley Bank common stock and series A preferred stock, including shareholders of record and shareholders who hold their shares through banks, brokers, nominees or any other holder of record, are invited to attend the special meeting. Shareholders of record can vote in person at the special meeting. If you are not a shareholder of record, you must obtain a proxy executed in your favor from the record holder of your shares, such as a broker, bank or other nominee, to be able to vote in person at the special meeting. If you plan to attend the special meeting, you must hold your shares in your own name or have a letter from the record holder of your shares confirming your ownership and you must bring a form of personal photo identification with you in order to be admitted.

## THE MERGER

### Background of the Merger

The Diablo Valley Bank Board of Directors has periodically discussed and reviewed Diablo Valley Bank's business, strategic direction, performance and prospects in the context of developments in the financial services industry and the competitive landscape in the markets in which Diablo Valley Bank operates and elsewhere. The Diablo Valley Bank Board of Directors has also at times discussed with senior management various potential strategic alternatives involving possible acquisitions or business combinations that could complement and enhance the company's competitive strengths and strategic position. Also, senior management of Diablo Valley Bank has, from time to time, had informal discussions with representatives of other financial institutions regarding industry trends and issues and exploratory discussions of the potential benefits and issues arising from possible business combinations.

Heritage Commerce Corp's Board of Directors and senior management regularly review the financial services industry environment, including the trend towards consolidation in the industry, and periodically discuss ways in which to enhance the company's competitive position. Senior management of Heritage Commerce Corp has, over time, considered the possibility of acquisitions and strategic combinations with a variety of financial institutions and the potential strategic fit with such institutions based on their lines of businesses, their management and employee cultures and their geographic locations.

In June 2006, John J. Hounslow, Chairman of the Board of Diablo Valley Bank, contacted William Del Biaggio Jr., Executive Vice-President and former Chairman of the Board of Heritage Commerce Corp, to get reacquainted socially. At a meeting on July 18, 2006, Mr. Del Biaggio suggested that Mr. Hounslow meet Walter T. Kaczmarek, the Chief Executive Officer of Heritage Commerce Corp and President of Heritage Bank of Commerce, as an introductory meeting to enable them to get acquainted, and to discuss Heritage Commerce Corp's present and future interests in expanding its banking activities.

In August 2006, Mr. Kaczmarek and Mr. Hounslow met for the first time to get acquainted. In the course of the meeting Mr. Kaczmarek and Mr. Hounslow generally discussed each other's franchises and the interest of Heritage Commerce Corp in expanding its franchise in the San Francisco East Bay.

After the initial meeting in August 2006, and continuing through November 2006, Mr. Hounslow met with and had telephonic discussions with Mr. Kaczmarek. These discussions included the potential strategic fit, benefits, advantages and merits of a merger of Diablo Valley Bank and Heritage Bank of Commerce. In late October 2006, at the request of Messrs. Kaczmarek and Hounslow, respectively, Randall Greenfield, chief financial officer of Diablo Valley Bank, spoke with and had a few discussions with Lawrence McGovern, chief financial officer of Heritage Commerce Corp, concerning Diablo Valley Bank's financial position and financial performance through the end of the third quarter of 2006.

On November 6, 2006, at the request of Diablo Valley Bank, Heritage Commerce Corp and Diablo Valley Bank executed a confidentiality agreement concerning proprietary information of Diablo Valley Bank, and Heritage Commerce Corp commenced its due diligence investigation of Diablo Valley Bank. Also during this period, Mr. Hounslow requested on behalf of Diablo Valley Bank that Heritage Commerce Corp provide a written list of potential terms for an acquisition of Diablo Valley Bank, indicating that while Diablo Valley Bank remained interested in a potential transaction, its Board of Directors believed that the previous indications of a possible purchase price were not sufficient to move forward.

On November 9, 2006, Mr. Hounslow, James Mayer, President of Diablo Valley Bank, Mr. Raymond Parker, Executive Vice President of Heritage Bank of Commerce, Mr. McGovern and Mr. Kaczmarek met for lunch to discuss and determine senior management compatibility.

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Heritage Commerce Corp Board of Directors at its regular November 16, 2006 meeting reviewed and discussed the status of negotiations with management. At the board meeting the board authorized management to continue negotiations, including a purchase price within specific ranges. The board also authorized management to enter into an engagement arrangement with RBC Capital Markets to act as the exclusive financial advisor to Heritage Commerce Corp. The next day on November 17, 2006 Mr. Kaczmarek contacted Mr. Hounslow to continue negotiations. Negotiations between the two companies ensued during the rest of the week on the pricing and structure of a proposed transaction.

On November 26, 2006, Diablo Valley Bank executed a confidentiality agreement concerning proprietary information of Heritage Commerce Corp and Heritage Bank of Commerce in order to commence due diligence into the affairs of Heritage Commerce Corp and Heritage Bank of Commerce. On November 30, 2006, Heritage Commerce Corp executed an engagement letter with RBC Capital Markets to act as its investment banking advisor for a possible transaction with Diablo Valley Bank. During the weeks of December 4 and December 11, 2006 Diablo Valley Bank and Heritage Commerce Corp had further discussions about preliminary structuring and pricing for a possible transaction.

As a result of these discussions, Heritage Commerce Corp proposed that, subject to the finalization of due diligence and definitive deal documentation, subject to the Diablo Valley Bank board members' willingness to enter into voting agreements to support the transaction, and further subject to certain executives and key employees of Diablo Valley Bank entering into employment, consulting and non-competition arrangements, Heritage Commerce Corp would be willing to pay a purchase price of 1,732,298 shares of common stock and \$23.5 million cash for all of the outstanding shares of Diablo Valley Bank and termination of all of the Diablo Valley Bank outstanding stock options. Following discussions among the Diablo Valley Bank board and its senior management, financial advisors and legal counsel, the Diablo Valley Bank board determined that such a transaction appeared to be in the best interests of its shareholders and instructed management, certain directors and Diablo Valley Bank's advisors to negotiate definitive transaction documentation, including the proposed voting agreements.

On December 12, 2006, Diablo Valley Bank retained Howe Barnes Hoefler & Arnett to render financial advisory and investment banking services.

On December 16, 2006, Heritage Commerce Corp conducted on-site due diligence and investigation of Diablo Valley Bank. On December 22, 2006, Diablo Valley Bank conducted on-site due diligence and investigation of Heritage Commerce Corp and Heritage Bank of Commerce.

On December 19, 2006, preliminary drafts of the merger agreement and shareholder voting agreements were distributed to all parties and their legal counsel.

On December 21, 2006, at its regular board meeting the Heritage Commerce Corp board discussed the proposal terms of the merger. RBC Capital and Heritage Commerce Corp legal counsel attended the meeting to discuss the financial terms and structure of the proposed transaction and the legal and regulatory issues involved in completing a possible transaction with Diablo Valley Bank.

For the balance of December through February 8, 2007, the parties continued to negotiate the final terms of the transaction and the definitive transaction documentation. During this period, Diablo Valley Bank completed its due diligence investigation of Heritage Commerce Corp and Heritage Commerce Corp completed its due diligence investigation of Diablo Valley Bank. The parties also negotiated during this period to enter into employment arrangements with certain key members of Diablo Valley Bank's senior management, a consulting agreement with Mr. Hounslow, an employment agreement with James Mayer, and non-competition agreements with Mr. Hounslow and Mr. Mayer as required by Heritage Commerce Corp as a condition to a transaction.

On February 8, 2007, the Diablo Valley Bank Board of Directors met. Mr. Hounslow updated the board on the progress of negotiations with Heritage Commerce Corp. Senior management then described

to the board the due diligence regarding Heritage Commerce Corp conducted by Diablo Valley Bank and its advisors. Representatives of Bingham McCutchen LLP, outside legal counsel to Diablo Valley Bank, then made a presentation to the board describing the board's duties and responsibilities under California law and the key terms of the merger and the merger agreement, and a discussion followed. Representatives of Howe Barnes Hoefler & Arnett then presented a summary of its financial analysis of the proposed merger and delivered its opinion that, as of that date, the consideration to be received by Diablo Valley Bank's shareholders in the merger was fair from a financial point of view to Diablo Valley Bank's shareholders. A discussion followed. Following further discussion and deliberations, including consideration of the matters described below under "Diablo Valley Bank's Reasons for the Merger; Recommendation of the Diablo Valley Bank Board of Directors," the members of the board present at the meeting unanimously approved the merger agreement and the transactions contemplated by the merger agreement and resolved to recommend that Diablo Valley Bank's shareholders vote to adopt the merger agreement.

The Board of Directors of Heritage Commerce Corp and Heritage Bank of Commerce also met on February 8, 2007 to approve the terms of the agreement and plan of merger.

Thereafter, on February 8, 2007, the parties executed the merger agreement, the voting agreements and the employment, consulting and non-competition agreements with members of Diablo Valley Bank Management. On the next day, February 9, 2007, the transaction was announced in a joint press release, and Heritage Commerce Corp filed a Form 8-K with the SEC to disclose the transaction.

#### **Diablo Valley Bank's Reasons for the Merger; Recommendation of the Diablo Valley Bank Board of Directors**

In reaching its conclusion that the merger agreement and the merger are advisable and in the best interests of Diablo Valley Bank and its shareholders, and in approving the merger agreement and the transactions contemplated thereby, Diablo Valley Bank's Board of Directors considered and reviewed the transaction and its terms with Diablo Valley Bank's senior management, as well as its financial and legal advisors, and considered a number of factors. The following include the material factors considered by Diablo Valley Bank's Board of Directors:

- the value to be received by Diablo Valley Bank shareholders under the merger agreement relative to the historical trading price of Diablo Valley Bank common stock, including the fact that as of the date of the merger agreement, the average implied value of the cash and stock merger consideration represented a premium of approximately 16% over the weighted average sale price of Diablo Valley Bank common stock over the two months preceding the announcement of the proposed merger;
- the value to be received in the merger is supported by certain collars including a floor price of \$23.00 share;
- the greater liquidity of the Heritage Commerce Corp common stock relative to the Diablo Valley Bank common stock;
- the ability of Diablo Valley Bank shareholders, through the Heritage Commerce Corp common stock component of the merger consideration, to participate in the potential growth of the combined Heritage Commerce Corp and Diablo Valley Bank institutions following consummation of the transaction;
- the financial analyses conducted by Howe Barnes Hoefler & Arnett and its opinion to the Board of Directors that, as of the date of the merger agreement, the consideration to be received by Diablo Valley Bank's shareholders was fair from a financial point of view to Diablo Valley Bank's shareholders;

- the expectation that the receipt of Heritage Commerce Corp common stock by Diablo Valley Bank shareholders would generally be tax-free for U.S. federal income tax purposes;
- the board's understanding of, and the presentations of its management and financial advisor regarding, Diablo Valley Bank's business, operations, management, financial condition, earnings and prospects;
- the potential alternatives available to Diablo Valley Bank, including other potential extraordinary transactions and the alternative of remaining independent, and the risks and challenges inherent in successfully implementing Diablo Valley Bank's business plans. The board also considered the value to the shareholders of these alternatives, the timing and likelihood of achieving value from these alternatives, and the possibility that Diablo Valley Bank's future stock price might not have a value greater than the consideration to be paid in the merger;
- the interest rate and economic environment and management's view of their impact on regional banks like Diablo Valley Bank over the near and medium term;
- the competitive environment facing regional banks like Diablo Valley Bank, and management's belief that Diablo Valley Bank's customers and employees would benefit from a combination with Heritage Commerce Corp due to the combined entity's enhanced ability to serve its customers more broadly and effectively because of the combined entity's greater scale, broader product portfolio and more comprehensive technology;
- the consolidation occurring in the banking industry and the increased competition from other financial institutions;
- the expertise of Heritage Commerce Corp's management, its competitive position in geographic markets and the proximity and overlap of the geographic markets served by Heritage Commerce Corp;
- the ability to complete the merger, including, in particular, the likelihood of obtaining regulatory approval and the provisions of the merger agreement regarding Diablo Valley Bank's and Heritage Commerce Corp's obligations to pursue the regulatory approvals;
- the terms and conditions of the merger agreement, including the restrictions imposed on Diablo Valley Bank from soliciting alternative transactions and the termination fee that Diablo Valley Bank would be required to pay if the merger agreement were terminated under certain circumstances;
- the existence and nature of the voting agreements;
- the judgment and advice of Diablo Valley Bank's senior management;
- the taxable nature for U.S. federal income tax purposes of the cash portion of the merger consideration received by Diablo Valley Bank shareholders; and
- the fact that the interests of certain of Diablo Valley Bank's officers and directors may be different from, or in addition to, the interests of shareholders generally.

The Diablo Valley Bank Board of Directors also identified and considered a number of risks and uncertainties in its deliberations concerning the merger, including the following:

- the possible disruption to Diablo Valley Bank's business that may result from the announcement of the transaction and the resulting distraction of its management's attention from the day-to-day operations of Diablo Valley Bank's

business;

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- the difficulty inherent in integrating two businesses and the risk that the cost efficiencies, synergies and other benefits expected to be obtained in the transaction may not be fully realized;
- the restrictions contained in the merger agreement on the operation of Diablo Valley Bank's business during the period between the signing of the merger agreement and completion of the merger;
- the termination fee to be paid to Heritage Commerce Corp if the merger agreement is terminated under certain circumstances; and
- the possibility that the merger might not be completed and the effect of the resulting public announcement of termination of the merger agreement on, among other things, the market price of Diablo Valley Bank's common stock and Diablo Valley Bank's operating results, particularly in light of the costs incurred in connection with the transaction.

The above discussion of the information and factors considered by Diablo Valley Bank's Board of Directors is not intended to be exhaustive, but indicates the material matters considered by the Board of Directors. In reaching its determination to approve the merger agreement and the transactions which it contemplates, the board did not quantify, rank or assign any relative or specific weight to, the foregoing factors, and individual directors may have considered various factors differently and may have given differing weights to different factors. Diablo Valley Bank's Board of Directors did not undertake to make any specific determination as to whether any factor, or any particular aspect of any factor, supported or did not support its ultimate determination. Diablo Valley Bank's Board of Directors based its determination on the totality of the information presented.

**Diablo Valley Bank's Board of Directors determined, by unanimous vote that the merger on the terms and conditions set forth in the merger agreement is advisable and in the best interests of Diablo Valley Bank and its shareholders. Accordingly, Diablo Valley Bank's Board of Directors, by unanimous vote, approved and adopted the merger agreement and the transactions contemplated thereby, and recommends that Diablo Valley Bank shareholders vote FOR the proposal to approve the merger agreement.**

#### **Opinion of Diablo Valley Bank's Financial Advisor**

Diablo Valley Bank's Board of Directors retained Howe Barnes Hoefler & Arnett to render financial advisory and investment banking services. Howe Barnes Hoefler & Arnett is a nationally recognized investment banking firm with substantial expertise in transactions similar to the proposed transaction and is familiar with Diablo Valley Bank and its business. As part of its investment banking activities, Howe Barnes Hoefler & Arnett is regularly engaged in the independent valuation of financial institutions and securities in connection with mergers, acquisitions, underwritings, sales and distributions of listed and unlisted securities, private placements and valuations for estate, corporate and other purposes.

On February 8, 2007, the Diablo Valley Bank Board of Directors held a meeting to evaluate the proposed merger with Heritage Bank of Commerce. At this meeting, Howe Barnes Hoefler & Arnett rendered a written opinion that the terms of the proposed merger of Diablo Valley Bank with and into Heritage Bank of Commerce was fair, from a financial point of view, to Diablo Valley Bank common shareholders. The full text of Howe Barnes Hoefler & Arnett's opinion is attached as Appendix B to this proxy statement/prospectus and should be read in its entirety.

For purposes of Howe Barnes Hoefler & Arnett's opinion and in connection with its review of the proposed transaction, Howe Barnes Hoefler & Arnett has, among other things:

- reviewed the terms of the merger agreement;

- reviewed certain publicly available financial statements, both audited (where available) and un-audited, and related financial information of Diablo Valley Bank and Heritage Commerce Corp, including those included in their respective annual reports for the past two years and their respective quarterly reports for the past two years;
- held discussions with members of senior management of Diablo Valley Bank and Heritage Commerce Corp regarding financial forecasts and projections of Diablo Valley Bank and Heritage Commerce Corp, as well as the amount and timing of the cost savings and related expenses and synergies expected to result from the Merger;
- held discussions with members of senior management of Diablo Valley Bank and Heritage Commerce Corp regarding past and current business operations, regulatory matters, financial condition and future prospects of the respective companies;
- reviewed reported market prices and historical trading activity of Diablo Valley Bank and Heritage Commerce Corp common stock;
- reviewed certain aspects of the financial performance of Diablo Valley Bank and Heritage Commerce Corp and compared such financial performance of Diablo Valley Bank and Heritage Commerce Corp, together with stock market data relating to Diablo Valley Bank and Heritage Commerce Corp common stock, with similar data available for certain other financial institutions and certain of their publicly traded securities;
- compared the proposed financial terms of the merger with the financial terms of certain other transactions that Howe Barnes Hoefler & Arnett deemed to be relevant; and
- reviewed the potential pro forma impact of the merger.

Howe Barnes Hoefler & Arnett has assumed and relied, without independent verification, upon the accuracy and completeness of all of the financial and other information that has been provided to it by Diablo Valley Bank, Heritage Commerce Corp, and their respective representatives, and of the publicly available information that was reviewed by it. Howe Barnes Hoefler & Arnett is not an expert in the evaluation of allowances for loan losses and has not independently verified such allowances, and has relied on and assumed that the aggregate allowances for loan losses set forth in the balance sheets of each of Diablo Valley Bank and Heritage Commerce Corp are adequate to cover such losses and complied fully with applicable law, regulatory policy and sound banking practice as of the date of such financial statements. Howe Barnes Hoefler & Arnett was not retained to and it did not conduct a physical inspection of any of the properties or facilities of Diablo Valley Bank or Heritage Commerce Corp, did not make any independent evaluation or appraisal of the assets, liabilities or prospects of Diablo Valley Bank or Heritage Commerce Corp, was not furnished with any such evaluation or appraisal, and did not review any individual credit files.

Howe Barnes Hoefler & Arnett's opinion is necessarily based on economic, market, and other conditions as in effect on, and the information made available to it as of, the date hereof. Events occurring after the date of issuance of the opinion, including but not limited to, changes affecting the securities markets, the results of operations or material changes in the assets or liabilities of Diablo Valley Bank or Heritage Commerce Corp could materially affect the assumptions used in preparing the opinion. Howe Barnes Hoefler & Arnett assumed that all of the representations and warranties contained in the merger agreement and all related agreements are true and correct, that each party to such agreements will perform all of the covenants required to be performed by such party under such agreements and that the conditions precedent in the merger agreement are not waived.

No limitations were imposed by Diablo Valley Bank's Board of Directors upon Howe Barnes Hoefler & Arnett with respect to the investigations made or procedures followed in rendering its opinion.



Howe Barnes Hoefler & Arnett's opinion as expressed herein is limited to the fairness, from a financial point of view, of the merger consideration to be paid by Heritage Commerce Corp to holders of Diablo Valley Bank common stock in the merger and does not address Diablo Valley Bank's underlying business decision to proceed with the merger. Howe Barnes Hoefler & Arnett has been retained on behalf of the Board of Directors of Diablo Valley Bank, and its opinion does not constitute a recommendation to any director of Diablo Valley Bank as to how such director should vote with respect to the merger.

Howe Barnes Hoefler & Arnett relied upon the managements of Diablo Valley Bank and Heritage Commerce Corp as to the reasonableness of the financial and operating forecasts, and projections (and the assumptions and bases therefor) provided to or reviewed by Howe Barnes Hoefler & Arnett, and Howe Barnes Hoefler & Arnett assumed that such forecasts and projections reflect the best currently available estimates and judgments of Diablo Valley Bank and Heritage Commerce Corp management. Diablo Valley Bank and Heritage Commerce Corp do not publicly disclose internal management forecasts, projections or estimates of the type furnished to or reviewed by Howe Barnes Hoefler & Arnett in connection with its analysis of the financial terms of the proposed transaction, and such forecasts and estimates were not prepared with a view towards public disclosure. These forecasts and estimates were based on numerous variables and assumptions which are inherently uncertain and which may not be within the control of the managements of Diablo Valley Bank or Heritage Commerce Corp, including without limitation to, the general economic, regulatory and competitive conditions. Accordingly, actual results could vary materially from those set forth in such forecasts and estimates.

In delivering its opinion to the Board of Directors of Diablo Valley Bank, Howe Barnes Hoefler & Arnett prepared and delivered to Diablo Valley Bank's Board of Directors written materials containing various analyses and other information. The following is a summary of the material financial analyses performed by Howe Barnes Hoefler & Arnett in connection with the preparation of its opinion and does not purport to be a complete description of all the analyses performed by Howe Barnes Hoefler & Arnett. The summary includes information presented in tabular format, which should be read together with the text that accompanies those tables. The preparation of a fairness opinion is a complex process involving various determinations as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances. Therefore, an opinion is not necessarily susceptible to partial analysis or summary description. Howe Barnes Hoefler & Arnett believes that its analyses must be considered as a whole and that selecting portions of such analyses and the factors considered therein, without considering all factors and analyses, could create an incomplete view of the analyses and the processes underlying its opinion. In its analyses, Howe Barnes Hoefler & Arnett made numerous assumptions with respect to industry performance, business and economic conditions, and other matters, many of which are beyond the control of Diablo Valley Bank, Heritage Commerce Corp and Howe Barnes Hoefler & Arnett. Any estimates contained in Howe Barnes Hoefler & Arnett's analyses are not necessarily indicative of future results or values, which may be significantly more or less favorable than such estimates. Estimates of values of companies do not purport to be appraisals or necessarily reflect the prices at which companies or their securities may actually be sold.

*Summary of Proposal.* Howe Barnes Hoefler & Arnett reviewed the financial terms of the proposed transaction. Subject to the provisions of the merger agreement, Heritage Commerce Corp will issue 1,732,298 common shares and pay \$15,012,876 cash for all common shares of Diablo Valley Bank currently outstanding.

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Based on 2,502,146 Diablo Valley Bank common shares outstanding and 647,125 options with an average exercise price of \$12.5666 per share and a market value of \$27.25 per share for Heritage Commerce Corp common stock (the closing price on February 8, 2007), the per share purchase price equaled \$24.87 and the aggregate transaction value equaled \$70,177,145.

<i>Aggregate Transaction Ratios:</i>		
Transaction Value to December 31, 2006 Common Book Value	4.01x	
Transaction Value to December 31, 2006 Tangible Common Book Value	4.01x	
Transaction Value to 2006 Earnings	34.96x	
Transaction Value to December 31, 2006 Assets	28.21	%
Tangible Premium on Core Deposits	27.14	%

*Analysis of Selected Public Companies.* Howe Barnes Hoefler & Arnett used publicly available information to compare selected financial and market trading information for Heritage Commerce Corp with those of a group of comparable publicly traded California banking organizations with total assets between \$800 million and \$1.5 billion. The companies in Heritage Commerce Corp's peer group were:

Alliance Bancshares California	Pacific Mercantile Bancorp
Bank of Marin	Preferred Bank
Beverly Hills Bancorp, Inc.	RCB Corporation
Exchange Bank of Santa Rosa	Sierra Bancorp
Farmers & Merchants Bancorp	Temecula Valley Bancorp, Inc.
North Valley Bancorp	

To perform this analysis, Howe Barnes Hoefler & Arnett used the most recently available data from SNL Financial and pricing data as of February 5, 2007. The following table sets forth the comparative financial and market data:

	<b>Heritage Commerce Corp</b>		<b>Peer Group Median</b>	
Total Assets (in millions)	\$ 1,037.1		\$ 1,214.8	
Equity/Assets	11.84	%	8.86	%
Loans/Deposits	85.73	%	93.77	%
Loan Loss Reserve/Loans	1.28	%	1.22	%
Return on Average Assets	1.57	%	1.38	%
Return on Average Equity	14.62	%	15.92	%
Nonperforming Assets/Assets	0.42	%	0.09	%
Efficiency Ratio	56.86	%	57.60	%
Price/Book Value Per Share	2.46x		2.29x	
Price/Tangible Book Value Per Share	2.46x		2.38x	
Price/Last 12 Months Earnings Per Share	18.0x		16.2x	

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Howe Barnes Hoefler & Arnett used publicly available information to compare selected financial and market trading information for Diablo Valley Bank with those of a group of comparable publicly traded California banking organizations with total assets between \$175 and \$300 million. The companies in Diablo Valley Bank's peer group were:

Ist Century Bank, N.A.	Orange County Business Bank
Canyon Bancorp	Professional Business Bank
Citizens Bancorp	Santa Lucia Bancorp
Coast Bancorp	Service 1st Bancorp
Commerce West Bank, N.A.	Sonoma Valley Bancorp
Discovery Bancorp	Summit Bancshares, Inc.
First Coastal Bancshares	Sunwest Bancorp
Mission Oaks Bancorp	United American Bank
NCAL Bancorp	Uniti Financial Corporation
NorCal Community Bancorp	Valley Commerce Bancorp
Northern California Bancorp, Inc.	

To perform this analysis, Howe Barnes Hoefler & Arnett used the most recently available data from SNL Financial and pricing data as of February 5, 2007. The following table sets forth the comparative financial and market data:

	<b>Diablo Valley Bank</b>	<b>Peer Group Median</b>	
Total Assets (in millions)	\$ 228.5	\$ 229.8	
Equity/Assets	10.29	% 9.60	%
Loans/Deposits	87.94	% 91.11	%
Loan Loss Reserve/Loans	1.27	% 1.30	%
Return on Average Assets	1.41	% 1.22	%
Return on Average Equity	13.04	% 12.35	%
Nonperforming Assets/Assets	0.00	% 0.03	%
Efficiency Ratio	59.04	% 62.02	%
Price/Book Value Per Share	3.52x	2.19x	
Price/Tangible Book Value Per Share	3.52x	2.19x	
Price/Last 12 Months Earnings Per Share	25.5x	17.6x	

*Stock Trading History.* Howe Barnes Hoefler & Arnett reviewed the closing per share market prices and volumes for Heritage Commerce Corp common stock, which is listed for trading on NASDAQ Global Select Market and Diablo Valley Bank common stock, which are listed for trading on in the over-the-counter market on the OTC Bulletin Board, on a monthly basis from January 1, 2005 to February 8, 2007.

For the period from January 1, 2005 to February 8, 2007, the adjusted closing price of Diablo Valley Bank common stock ranged from a low of \$18.00 to a high of \$26.25. The average adjusted closing price for the period was \$21.99, the closing price on February 8, 2007 was \$24.00 per share and the average daily trading volume for Diablo Valley Bank was 1,439 shares. The transaction price at announcement of \$24.87 represented a premium of 3.6% over Diablo Valley Bank's closing price on February 8, 2007.

For the period from January 1, 2005 to February 8, 2007, the market value of Heritage Commerce Corp common stock ranged from a low of \$18.16 to a high of \$27.25. The average closing price for the period was \$22.34, the closing price on February 8, 2007 was \$27.25 per share and the average daily trading volume for Heritage Commerce Corp was 28,371 shares.

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Howe Barnes Hoefler & Arnett compared the stock price performance for Diablo Valley Bank and Heritage Commerce Corp to movements in certain stock indices, including the Standard & Poor's 500 Index, the NASDAQ Bank Index and the median performance of publicly traded banking organizations located in the West. During the period between February 5, 2006 and February 5, 2007 Heritage Commerce Corp's common stock outperformed each of the indices to which it was compared (Source: SNL Financial).

	Beginning Index Value February 5, 2006	Ending Index Value February 5, 2007
Diablo Valley Bank	100.00 %	110.34 %
Heritage Commerce Corp	100.00 %	122.08 %
SNL Western Banks	100.00 %	112.18 %
NASDAQ Bank Index	100.00 %	108.56 %
S&P 500 Index	100.00 %	114.47 %

*Analysis of Selected Bank Merger Transactions.* Howe Barnes Hoefler & Arnett reviewed certain publicly available information regarding twenty selected merger and acquisition transactions (the *Comparable Transactions*) announced from January 1, 2005 to February 5, 2007 involving California banking organizations with total assets between \$100 and \$500 million. This data was obtained from SNL Financial. The transactions included in the group were (survivor/acquired entity):

- North Valley Bancorp / Yolo Community Bank
- Boston Private Financial Holdings / Encino State Bank
- Community Bancorp, Inc. / Cuyamaca Bank, N.A.
- American River Bankshares / Bank of Amador
- Placer Sierra Bancshares / First Financial Bancorp
- CVB Financial Corp / Granite State Bank
- Premier Valley Bank / Yosemite Bank
- FCB Bancorp / South Coast Bancorp, Inc.
- Pacific Capital Bancorp / First Bancshares, Inc.
- Community Bancorp, Inc. / Rancho Bernardo Community Bank
- First Community Bancorp / First American Bank
- First Banks Incorporated / International Bank of California
- MetroCorp Bancshares, Inc. / First United Bank
- First Community Bancorp / Pacific Liberty Bank
- First Community Bancorp / Cedars Bank
- Commercial Capital Bancorp, Inc. / CalNet Business Bank, N.A.

- Vineyard National Bancorp / Rancho Bank
- National Mercantile Bancorp / FCB Bancorp
- Industrial Bank of Taiwan / Evertrust Bank
- Belvedere Capital Partners LLC / Professional Business Bank

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Howe Barnes Hoefler & Arnett reviewed the multiples of transaction value to stated book value, transaction value to tangible book, transaction value to last twelve months earnings, transaction value to assets and tangible book premium to core deposits and calculated high, low, mean and median multiples for the Comparable Transactions. Howe Barnes Hoefler & Arnett compared these results with the transaction multiples derived from an aggregate purchase price of \$70,177,145. The results of the analysis are set forth in the following table.

	<b>Heritage Commerce Corp/ Diablo Valley Bank</b>	<b>Median</b>	<b>Average</b>	<b>High</b>	<b>Low</b>
Price/Common Book Value	4.01x	2.53x	2.52x	3.21x	1.77x
Price/Tangible Common Book Value	4.01x	2.53x	2.52x	3.21x	1.77x
Price/LTM Earnings	34.96x	24.12x	25.65x	45.10x	9.52x
Price/Assets	28.21 %	24.13 %	23.23 %	31.52 %	15.35 %
Tangible Premium/Core Deposits	27.14 %	20.41 %	20.94 %	38.44 %	9.52 %

No company or transaction used as a comparison in the above analysis is identical to Heritage Commerce Corp, Diablo Valley Bank or the merger. Accordingly, an analysis of these results is not strictly mathematical. An analysis of the results of the foregoing involves complex considerations and judgments concerning differences in financial and operating characteristics of Diablo Valley Bank and the companies included in the Comparable Transactions.

*Present Value Analysis.* Howe Barnes Hoefler & Arnett calculated the present value of theoretical future earnings of Diablo Valley Bank and compared the transaction value to the calculated present value of Diablo Valley Bank's stock on a stand-alone basis. Based on projected earnings for Diablo Valley Bank for 2007 through 2011, discount rates ranging from 10% to 18%, and including a residual value, the stand-alone present value of Diablo Valley Bank ranged from \$33.2 million to \$76.3 million. The aggregate transaction value of \$70.2 million falls within this range of values.

*Discounted Cash Flow Analysis.* Using a discounted cash flow analysis, Howe Barnes Hoefler & Arnett estimated the net present value of the future streams of after-tax cash flow that Diablo Valley Bank could produce to benefit a potential acquiror, referred to as dividendable net income, and added a terminal value. Based on projected earnings for Diablo Valley Bank for 2007 through 2011, Howe Barnes Hoefler & Arnett calculated assumed after-tax distributions to a potential acquiror such that its tier 1 leverage ratio would be maintained at 7.00%. The terminal values for Diablo Valley Bank were calculated based on Diablo Valley Bank's projected 2011 equity and earnings, the median price to book and price to earnings multiples paid in the Comparable Transactions and utilized a discount rate of 12%. This discounted cash flow analysis indicated implied values of \$59.2 million and \$101.7 million. The aggregate transaction value of \$70.2 million falls within this range of values.

*Pro Forma Merger Analysis.* Howe Barnes Hoefler & Arnett performed pro forma merger analyses to calculate the financial implications of the merger to the Diablo Valley Bank stockholders. This analysis assumes, among other things, the terms of the transaction as indicated above, that the merger closes at June 30, 2007 and cost savings and revenue enhancement opportunities equaling approximately 30% of Diablo Valley Bank's 2006 overhead expenses. This analysis indicated that the merger would be approximately 41% accretive to Diablo Valley Bank's projected earnings per share in 2007.

Howe Barnes Hoefler & Arnett has previously provided investment banking and financial advisory services to Diablo Valley Bank and Heritage Commerce Corp for which it received compensation. Howe Barnes Hoefler & Arnett provides a full range of financial advisory and securities services and, in the



course of its normal trading activities, may effect transactions and hold securities of Diablo Valley Bank and Heritage Commerce Corp for its own account and for the accounts of customers.

Pursuant to the terms of an engagement letter with Diablo Valley Bank, Howe Barnes Hoefler & Arnett will receive a fee from Diablo Valley Bank of \$404,000, which amounts to approximately 0.6% of the total merger consideration, and up to \$5,000 for expenses incurred. The fee is payable at and contingent upon the closing of the merger. In addition, Diablo Valley Bank has agreed to indemnify Howe Barnes Hoefler & Arnett against certain liabilities and expenses arising out of or incurred in connection with its engagement, including liabilities and expenses which may arise under the federal securities laws.

### **Public Trading Markets**

Heritage Commerce Corp common stock trades on the NASDAQ Global Select Market under the symbol HTBK . Diablo Valley Bank common stock trades on the Over-the-Counter Bulletin Board under the symbol DBVB . Upon completion of the merger, Diablo Valley Bank common stock will cease to trade. The Heritage Commerce Corp common stock issuable in the merger will be listed on the NASDAQ Global Select Market.

The shares of Heritage Commerce Corp common stock to be issued in connection with the merger will be freely transferable under the Securities Act of 1933, as amended, which we refer to as the Securities Act, except for shares issued to any shareholder who is an affiliate of Diablo Valley Bank, as discussed in The Merger Agreement Resales of Heritage Commerce Corp Stock by Affiliates on page [\*].

### **Regulatory Approvals Required for the Merger**

We have agreed to use our reasonable best efforts to obtain all regulatory approvals required to complete the transactions contemplated by the merger agreement. These approvals include approval from the Federal Reserve Board and the California Department of Financial Institutions. Heritage Commerce Corp and Diablo Valley Bank have completed, or will complete, the filing of applications and notifications to obtain the required regulatory approvals and/or waivers therefrom.

*Federal Reserve Board.* The merger is subject to approval by the Federal Reserve Board pursuant to Section 3 of the Bank Holding Company Act of 1956. The Federal Reserve Board is prohibited from approving any transaction under the applicable statutes that (1) would result in a monopoly, (2) would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or (3) may have the effect in any section of the United States of substantially lessening competition, tending to create a monopoly or resulting in a restraint of trade, unless the Federal Reserve Board finds that the anti-competitive effects of the transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the communities to be served. In addition, in reviewing a transaction under the applicable statutes, the Federal Reserve Board will consider the financial and managerial resources of the companies and their subsidiary banks and the convenience and needs of the community to be served as well as the companies' effectiveness in combating money-laundering activities. In connection with its review, the Federal Reserve Board will provide an opportunity for public comment on the application for the merger, and is authorized to hold a public meeting or other proceeding if it determines that would be appropriate.

Under the Community Reinvestment Act of 1977, which we refer to as the CRA, the Federal Reserve Board must take into account the record of performance of each of Heritage Commerce Corp and Diablo Valley Bank in meeting the credit needs of the entire communities, including low- and moderate-income neighborhoods, served by the company and its subsidiaries. Heritage Commerce Corp's and Diablo Valley Bank's depository institutions each have a satisfactory CRA rating.



*Antitrust Considerations.* At any time before or after the acquisition is completed, the Antitrust Division of the United States Department of Justice or the United States Federal Trade Commission, which we refer to as the Antitrust Division and the FTC, respectively, could take action under the antitrust laws as it deems necessary or desirable in the public interest, including seeking to enjoin the acquisition or seeking divestiture of substantial assets of Heritage Commerce Corp or Diablo Valley Bank or their subsidiaries. Private parties also may seek to take legal action under the antitrust laws under some circumstances. Based upon an examination of information available relating to the businesses in which the companies are engaged, Heritage Commerce Corp and Diablo Valley Bank believe that the completion of the merger will not violate U.S. antitrust laws. However, Heritage Commerce Corp and Diablo Valley Bank can give no assurance that a challenge to the merger on antitrust grounds will not be made, or, if such a challenge is made, that Heritage Commerce Corp and Diablo Valley Bank will prevail.

*Timing.* We cannot assure you that all of the regulatory approvals described above will be obtained, and, if obtained, we cannot assure you as to the date of any approvals or the absence of any litigation challenging such approvals. Likewise, we cannot assure you that the Antitrust Division, the FTC or any state attorney general will not attempt to challenge the merger on antitrust grounds, and, if such a challenge is made, we cannot assure you as to its result.

Pursuant to the Bank Holding Company Act, a transaction approved by the Federal Reserve Board may not be completed until 30 days after approval is received, during which time the Antitrust Division may challenge the merger on antitrust grounds. The commencement of an antitrust action would stay that is, suspend the effectiveness of an approval unless a court specifically were to order otherwise. With the approval of the Federal Reserve Board and the concurrence of the Antitrust Division, the waiting period may be reduced to no less than 15 days.

*California Department Of Financial Institutions.* The California Commissioner of Financial Institutions may not approve the acquisition of control of a state bank, such as Diablo Valley Bank, if the Commissioner finds that any of the following are true:

- that the proposed acquisition of control would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the state of California;
- that the effect of the proposed acquisition of control in any section of the state of California may be substantially to lessen competition or to tend to create a monopoly or that the proposed acquisition of control would in any other manner be in restraint of trade, and that the anticompetitive effects of the proposed acquisition of control are not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served;
- that the financial condition of the acquiror is such as might jeopardize the financial stability of the bank or the acquiror, or prejudice the interest of the depositors, creditors, or shareholders of the bank or the acquiror;
- that plans or proposals to liquidate the bank or the acquiror, to sell the assets of the bank or the acquiror, to merge or consolidate the bank or the acquiror, or to make any other major change in the business, corporate structure or management of the bank or the acquiror are not fair and reasonable to the depositors, creditors, and shareholders of the bank or the acquiror;
- that the competence, experience or integrity of the acquirer indicates that it would not be in the interest of the depositors, creditors or shareholders of the bank or the acquiror or in the interest of the public to permit such person to control the bank or the acquiror;
- that the proposed acquisition is unfair, unjust or inequitable to the bank or the acquiror or to the depositors, creditors or shareholders of the bank or the acquiror; or



- that the applicant neglects, fails or refuses to furnish to the Commissioner all the information required by the Commissioner.

The Commissioner will either approve or deny the acquisition within a period of 60 days from the filing of the application. Such period may be extended with the consent of Heritage Commerce Corp.

Diablo Valley Bank must also obtain the approval of the California Department of Financial Institutions before redeeming its series A preferred stock. The redemption of the series A preferred stock is a condition of the merger.

Heritage Commerce Corp and Diablo Valley Bank believe that the merger does not raise substantial antitrust or other significant regulatory concerns and that they will be able to obtain all requisite regulatory approvals on a timely basis without the imposition of any condition that would have a material adverse effect on Heritage Commerce Corp or Diablo Valley Bank. In connection with obtaining any required regulatory approvals, Heritage Commerce Corp is not required to agree to conditions or restrictions that in its reasonable opinion would have a material adverse effect on Heritage Commerce Corp, or otherwise be materially burdensome.

We are not aware of any material governmental approvals or actions that are required for completion of the merger other than those described above. It is presently contemplated that if any such additional governmental approvals or actions are required, those approvals or actions will be sought and obtained. There can be no assurance, however, that any additional approvals or actions will be obtained.

#### **Diablo Valley Bank's Directors and Officers Have Interests in the Merger**

In considering the recommendation of the Diablo Valley Bank Board of Directors with respect to the merger agreement, Diablo Valley Bank's shareholders should be aware that some of Diablo Valley Bank's executive officers and directors have interests in the merger that may be different from, or in addition to, those of Diablo Valley Bank's shareholders generally. The Diablo Valley Bank Board of Directors was aware of these interests and considered them, among other matters, in reaching its decisions to approve the merger agreement and to recommend that Diablo Valley Bank's shareholders vote in favor of approving the merger agreement.

*Executive Officer and Board of Directors Stock Options.* The merger agreement provides that upon completion of the merger, each Diablo Valley Bank stock option held by current employees, including members of the Board of Directors and each of the executive officers of Diablo Valley Bank, will be cancelled and converted into the right to receive upon completion of the merger an amount in cash per share subject to the option equal to the excess, if any, of the per share consideration payable in the merger over the per share exercise price of the option.

*Severance Benefits.* Randall Greenfield, the Chief Financial Officer of Diablo Valley Bank, is a party to an employment agreement with Diablo Valley Bank that provides for severance benefits upon the occurrence of a termination of employment. The merger with Heritage Commerce Corp will constitute a change in control under this agreement and Heritage Commerce Corp has indicated that it does not currently plan to employ Mr. Greenfield beyond a short transition period following the merger effective date. Consequently, if Mr. Greenfield is terminated he will be entitled to receive a change in control payment equal to 12 months of his current base salary or \$130,000.

During the course of negotiations, Heritage Commerce Corp indicated that in order for it to proceed with a definitive transaction certain agreements would have to be reached with certain executive and key employees of Diablo Valley Bank.

*John J. Hounslow Agreements.* Heritage Bank of Commerce has entered into a consulting agreement with Mr. Hounslow pursuant to which Mr. Hounslow will provide consulting regarding post-merger

transition issues, including retention and transition of employees and customers, marketing the Heritage brand name and such other services as may be assigned to him from time to time by the president of Heritage Bank of Commerce. The agreement becomes effective on the effective date of the merger and extends for a term that expires on December 31, 2007. Mr. Hounslow will receive a consulting fee of \$400,000 payable to him pro rata over a 30 month period that commences on the first month following the month of the effective date of the merger. Mr. Hounslow also agreed to enter into a 3-year non-competition, non-solicitation and confidentiality agreement with Heritage Commerce Corp and Heritage Bank of Commerce pursuant to which he will receive \$200,000 payable pro rata over 30 months commencing on the first month following the month of the effective date of the merger. In consideration for entering into the agreements with Heritage Commerce Corp and Heritage Bank of Commerce, Mr. Hounslow agreed to forgo an amount equal to 12 months of his current salary due him for severance under his existing employment agreement with Diablo Valley Bank and agreed to terminate the employment agreement effective the effective date of the merger.

*James Mayer Agreements.* Heritage Bank of Commerce has entered into a 3 year employment agreement with Mr. Mayer that will become effective on the effective date of the merger. Mr. Mayer will serve as executive vice president of Heritage Bank of Commerce. Over the 36 months of the agreement he will receive an annual base salary of \$220,000 for the first 12 months, \$240,000 for the second 12 months and \$250,000 for the third 12 months. At the end of 18 months Mr. Mayer will have opportunity for a 30-day period to terminate the agreement and his employment with 30 days prior written notice and from the effective date of termination receive a severance amount of \$300,000 payable pro rata over the next following 18 months. If Mr. Mayer is otherwise terminated without cause or terminated in connection with a change of control he will be entitled to accrued salary and benefits and a lump sum severance payment equal to the greater of (x) 12 months of base salary then in effect, plus the highest annual bonus paid or payable during the term of the agreement (not to exceed \$100,000), (y) or an amount equal to the number of months remaining on the term of the agreement at the time of termination multiplied by the base salary then in effect at the time of termination. The employment agreement may be terminated for cause by Heritage Bank of Commerce. Mr. Mayer is entitled to an annual bonus under the Heritage Management Incentive Plan, subject to the terms of such plan. Mr. Mayer will participate in other benefit programs offered executives of the bank. He will have the use of an automobile provided to him by the bank with the obligation of the bank not to exceed a lease payment of \$750 per month. Mr. Mayer will also be entitled to receive 20,000 stock options under the Heritage Commerce Corp 2004 Stock Option Plan subject to approval by the Heritage Commerce Corp Compensation Committee and Board of Directors and the terms of the option plan. The stock options will have an exercise price per share equal to the fair market value of the Heritage Commerce Corp common stock on the date of grant (which will be the day Mr. Mayer commences employment). Under the terms of the employment agreement, Mr. Mayer has agreed to not solicit employees and customers in accordance with the terms and for the periods set forth in the employment agreement. Mr. Mayer also agreed to enter into a 3-year non-competition, non-solicitation and confidentiality agreement with Heritage Commerce Corp and Heritage Bank of Commerce in consideration for entering into the agreements with Heritage Commerce Corp and Heritage Bank of Commerce in recognition of his prior position with Diablo Valley Bank as President and a significant shareholder. Mr. Mayer agreed to forgo an amount equal to 12 months of his current salary due him for severance under his existing employment agreement with Diablo Valley Bank and agreed to terminate the employment agreement effective the effective date of the merger.

*Board Positions.* John J. Hounslow, Chairman of the Board, and Mark E. Lefanowicz, a member of the Diablo Valley Bank Board of Directors, will be named to serve on the boards of directors of Heritage Commerce Corp and Heritage Bank of Commerce as of the effective date of the merger. They will receive the same compensation for their service paid to the other board members of Heritage Commerce Corp and Heritage Bank of Commerce. In addition, so long as he is on the board, Mr. Hounslow will be entitled to the use of an automobile, use of his current office at Diablo Valley Bank and reimbursement for country

club dues. Mr. Hounslow will be named to the Heritage Commerce Corp Board of Directors strategic planning committee and finance committee. Heritage Commerce Corp has also agreed to nominate Messrs. Hounslow and Lefanowicz to the Board of Directors for 2008 and 2009, provided they have complied with the Board of Directors policies in effect from time to time.

*Other Employment Agreements.* Heritage Bank of Commerce has entered into employment agreements which become effective on the merger effective date with three other non-executive employees of Diablo Valley Bank.

*Indemnification and Insurance.* Heritage Commerce Corp has agreed to indemnify and hold harmless each present and former director and officer of Diablo Valley Bank from liability and expenses for matters arising at or prior to the consummation of the merger to the fullest extent permitted by applicable law. Heritage Commerce Corp has also agreed, subject to certain limitations, to maintain tail coverage under Diablo Valley Bank's current policy of directors and officers liability insurance coverage for the benefit of Diablo Valley Bank's directors and officers for five years following consummation of the merger.

## **THE MERGER AGREEMENT**

*The following describes certain aspects of the merger, including material provisions of the merger agreement. The following description of the merger agreement is subject to, and qualified in its entirety by reference to, the merger agreement, which is attached to this document as Appendix A and is incorporated by reference in this document. We urge you to read the merger agreement carefully and in its entirety, as it is the legal document governing this merger.*

### **Terms of the Merger**

Each of the Diablo Valley Bank Board of Directors and the Heritage Commerce Corp Board of Directors has approved the merger agreement which provides for the merger of Diablo Valley Bank with and into Heritage Bank of Commerce. Heritage Bank of Commerce will be the surviving corporation in the merger. The Heritage Bank of Commerce articles of incorporation will be the articles of incorporation, and the Heritage Bank of Commerce bylaws will be the bylaws, of the combined company after completion of the merger. The merger agreement provides that Heritage Commerce Corp may change the structure of the merger to change the method of effecting the combination provided that such change does not alter the amount or kind of merger consideration to be provided under the merger agreement, adversely affect the tax consequences to Diablo Valley Bank shareholders in the merger or materially impede or delay completion of the merger.

### **Merger Consideration**

Each share of Heritage Commerce Corp common stock issued and outstanding immediately prior to completion of the merger will remain issued and outstanding as one share of common stock of Heritage Commerce Corp, and each share of Diablo Valley Bank common stock issued and outstanding immediately prior to the completion of the merger will have the right to elect to receive, subject to potential proration, cash or Heritage Commerce Corp common stock for each share of Diablo Valley Bank common stock outstanding immediately prior to the merger. If you are a shareholder of record of Diablo Valley Bank common stock you may make different elections with respect to different shares. For example, if you are the record holder of 10,000 shares of Diablo Valley Bank common stock, you may elect to have 3,000 of those shares converted into the cash consideration and 7,000 of those shares converted into the Heritage Commerce Corp common stock consideration, subject to potential adjustment as described below. If you hold your stock in street name through a bank or broker, your election procedures may be subject to further limitations imposed by your bank or broker.

The applicable election materials were mailed to Diablo Valley Bank shareholders together with this document. Diablo Valley Bank shareholders must return their properly completed and signed form of election to the exchange agent prior to the election deadline in the enclosed **BLUE** envelope. If you are a Diablo Valley Bank shareholder and you do not return your form of election by the election deadline or improperly complete or do not sign your form of election, you will receive cash, shares of Heritage Commerce Corp common stock or a mixture of cash and shares of Heritage Commerce Corp common stock, based on what is available after giving effect to the valid elections made by other shareholders.

*Cash Elections.* Each share of Diablo Valley Bank common stock converted into the cash consideration will be exchanged for the *per share consideration*.

*Stock Elections.* Each share of Diablo Valley Bank common stock converted into the stock consideration will be exchanged based on the *exchange ratio*, which will vary, determined by the *per share consideration* divided by the average closing price reported on the NASDAQ Global Select Market for the 20 trading days ending on the fifth trading day immediately before the effective date of the merger.

The *per share consideration* will be calculated with reference to the *average closing price* of the Heritage Commerce Corp common stock on the NASDAQ Global Select Market for the 20 day trading period ending on the 5th business day prior to the effective date of the merger. The *per share consideration* will float within a band of \$23.00 to \$25.00 if the *average closing price* is between \$24.55 and \$27.44. If the *average closing price* is above \$27.44, the *per share consideration* will be increased to reflect one third of the increase in value of Heritage Commerce Corp common stock issued above \$27.44. If the *average closing price* is below \$24.55, the aggregate amount of cash paid in the transaction will be increased by Heritage Commerce Corp sufficient to maintain the *per share consideration* at \$23.00. Heritage Commerce Corp has the right to terminate the transaction if the *average closing price* is less than \$23.50.

Thus, by way of example only, if the *average closing price* of Heritage Commerce Corp common stock on the NASDAQ Global Select Market for the 20 trading days ending on the fifth trading day immediately before the effective date of the merger were \$26.00 per share, the *per share consideration* would be \$24.00 and the *exchange ratio* would be 0.9231. Under that example, if you owned 10,000 shares of Diablo Valley Bank common stock and elected stock consideration, you would receive 9,230 shares of Heritage Commerce Corp common stock in the merger. If you elected the cash consideration you would receive \$240,000 cash.

Heritage Commerce Corp will not issue any fractional shares of its common stock in the merger. Instead, a Diablo Valley Bank shareholder who otherwise would have received a fraction of a share of Heritage Commerce Corp common stock will receive an amount in cash, rounded to the nearest cent, equal to the product of the fraction of a share of Heritage Commerce Corp common stock to which the holder would otherwise be entitled and the per share consideration.

The merger agreement provides that no more than 1,732,298 shares of Heritage Commerce Corp common stock will be issued for the Diablo Valley Bank shares outstanding immediately prior to completion of the merger with the balance of the per share consideration payable in cash. As a result, if more shareholders elect to receive either form of consideration than is available under the merger agreement, shareholders electing the over-subscribed form of consideration will have their elections proportionately reduced and will receive a portion of their consideration in the other form, despite their election.

*Non-Elections.* Diablo Valley Bank shareholders who do not make an election to receive cash or Heritage Commerce Corp common stock in the merger, whose elections are not received by the exchange agent by the election deadline, or whose forms of election are improperly completed and/or are not signed, will be deemed not to have made an election. Shareholders not making an election may be paid in only cash, only Heritage Commerce Corp common stock or a mix of cash and shares of Heritage Commerce

Corp common stock depending on, and after giving effect to, the number of valid cash elections and stock elections that have been made by other Diablo Valley Bank shareholders using the proration adjustment described below.

*Treatment of Diablo Valley Bank Stock Options.* Each outstanding option to purchase shares of Diablo Valley Bank common stock granted under the stock option plan maintained by Diablo Valley Bank, to individuals who are employees or directors of Diablo Valley Bank as of the completion of the merger, whether vested or not, will be cancelled and converted into the right to receive a lump sum cash payment equal to (1) the number of shares of Diablo Valley Bank common stock subject to the option immediately prior to the closing and (2) the excess of the per share consideration over the exercise price per share of the option. The lump sum cash payment shall be subject to applicable tax withholding.

*Proration.* The merger agreement provides that shares of Diablo Valley Bank common stock outstanding immediately prior to completion of the merger will be converted into a maximum aggregate of 1,732,298 shares of Heritage Commerce Corp common stock, with the remaining merger consideration consisting of cash. As a result, if more Diablo Valley Bank shareholders make valid elections to receive either cash or Heritage Commerce Corp common stock than is available as merger consideration under the merger agreement, those Diablo Valley Bank shareholders electing the over-subscribed form of consideration will have the over-subscribed consideration proportionately reduced and will receive a portion of their consideration in the other form, despite their election. We refer in this document to the number of Diablo Valley Bank shares to be converted into cash as the cash conversion number.

If the total number of shares of Diablo Valley Bank common stock with respect to which elections to receive the cash merger consideration are made or that dissent from the merger and seek appraisal rights (we refer to these shares as cash election shares ) exceeds the cash conversion number, then all Diablo Valley Bank shares with respect to which elections were made to receive Heritage Commerce Corp common stock (we refer to these shares as stock election shares ), and all shares with respect to which no valid election was made, will be converted into the right to receive the stock merger consideration, and all cash election shares will be converted into the right to receive:

- the cash consideration in respect of that number of shares equal to the product obtained by multiplying
- the number of cash election shares held by the holder by
- a fraction, the numerator of which is the cash conversion number and the denominator of which is the total number of cash election shares,
- with the remainder of the shares converted into the stock consideration.

If the total number of cash election shares is less than the cash conversion number (we refer to the amount by which the cash conversion number exceeds the cash election number as the shortfall number ), then all cash election shares will be converted into the right to receive the cash consideration and the shares with respect to which no valid election was made will be treated in the following manner:

- if the shortfall number is less than or equal to the number of shares with respect to which no valid election was made, then all stock election shares will be converted into the right to receive the stock merger consideration, and each of the holders of non-electing shares will receive the cash consideration in respect of that number of non-electing shares as is equal to the product obtained by multiplying
- the number of non-electing shares held by such holder by
- a fraction, the numerator of which is the shortfall number and the denominator of which is the total number of shares with respect to which no valid election was made,





with the remaining number of such holder's non-electing shares being converted into the right to receive the stock consideration; and

- if the shortfall number exceeds the number of shares with respect to which no valid election was made, then all non-electing shares will be converted into the right to receive the cash merger consideration, and each of the holders of stock election shares will have the right to receive the cash consideration in respect of that number of stock election shares as is equal to the product obtained by multiplying
- the number of stock election shares held by such holder by
- a fraction, the numerator of which is the amount by which (1) the shortfall number exceeds (2) the total number of non-electing shares, and the denominator of which is the total number of stock election shares,

with the remaining number of such holder's stock election shares being converted into the right to receive the stock consideration.

#### **Closing and Effective Time of the Merger**

The merger will be completed only if all of the following occur:

- the merger is approved by Diablo Valley Bank shareholders;
- we obtain all required governmental and regulatory consents and approvals; and
- all other conditions to the merger discussed in this document and the merger agreement are either satisfied or waived.

The merger will become effective when the agreement of merger substantially in the form of Exhibit A to the merger agreement is filed with the Secretary of State of the State of California and the Commissioner of the California Department of Financial Institutions. In the merger agreement, we have agreed to cause the completion of the merger to occur as soon as practicable on a date mutually agreeable following the satisfaction or waiver of the last of the conditions specified in the merger agreement. It currently is anticipated that the effective time of the merger will occur in the second or third quarter of 2007, but we cannot guarantee when or if the merger will be completed.

#### **Conversion of Shares; Exchange of Certificates; Elections as to Form of Consideration**

The conversion of Diablo Valley Bank common stock into the right to receive the merger consideration will occur automatically at the effective time of the merger. As soon as reasonably practicable after the completion of the merger, the exchange agent will exchange certificates representing shares of Diablo Valley Bank common stock for merger consideration to be received in the merger pursuant to the terms of the merger agreement. U.S. Stock Transfer will be the exchange agent in the merger and will receive your form of election, exchange certificates for the merger consideration and perform other duties as explained in the merger agreement.

*Form of Election.* Enclosed with this proxy statement/prospectus is an election form and instructions for electing your preferred form of merger consideration and exchanging your shares of Diablo Valley Bank common stock. You may elect to receive all Heritage Commerce Corp common stock, all cash, or any combination of common stock and cash with respect to your shares, subject to the proration discussed earlier under the caption "Proration," or you may make no election. Please complete and return your election form together with your Diablo Valley Bank stock certificates in the separate **BLUE** envelope that is provided for that purpose. To be effective, an election form must be properly completed before the election deadline. Unless otherwise agreed to in advance by Heritage Commerce Corp and Diablo Valley



Bank, the election deadline will be 5:00 p.m., San Francisco, California time, on the date that is the business day immediately preceding the date of the special meeting of Diablo Valley Bank shareholders.

If you wish to elect the type of merger consideration you will receive in the merger, you should carefully review and follow the instructions that will be set forth in the form of election. Shareholders who hold their shares of Diablo Valley Bank common stock in street name or through a bank, broker or other nominee should follow the instructions of the bank, broker or other nominee for making an election with respect to such shares of Diablo Valley Bank common stock. Shares of Diablo Valley Bank common stock as to which the holder has not made a valid election prior to the election deadline will be treated as though they had not made an election. To make a valid election, each Diablo Valley Bank shareholder must submit a properly completed form of election, together with stock certificates, so that it is actually received by the exchange agent at or prior to the election deadline in accordance with the instructions on the form of election. A form of election will be properly completed only if accompanied by certificates (or book-entry transfer of uncertificated shares) representing all shares of Diablo Valley Bank common stock covered by the form of election (or appropriate evidence as to the loss, theft or destruction, appropriate evidence as to the ownership of that certificate by the claimant, and appropriate and customary indemnification, as will be described in the form of election). If you are a Diablo Valley Bank shareholder and you cannot deliver your stock certificates to the exchange agent by the election deadline, you may deliver a notice of guaranteed delivery promising to deliver your stock certificates, as will be described in the form of election, so long as (1) the guarantee of delivery is from a firm which is a member of any registered national securities exchange or a commercial bank or trust company in the United States and (2) the actual stock certificates are in fact delivered to the exchange agent by the time set forth in the guarantee of delivery.

Generally, an election may be revoked or changed, but only by written notice received by the exchange agent prior to the election deadline accompanied by a properly completed and signed revised form of election. If an election is revoked, or the merger agreement is terminated, and any certificates have been transmitted to the exchange agent, the exchange agent will promptly return those certificates to the shareholder who submitted those certificates via first-class mail. Diablo Valley Bank shareholders will not be entitled to revoke or change their elections following the election deadline. As a result, if you have made an election, you will be unable to revoke your elections or sell your shares of Diablo Valley Bank common stock during the interval between the election deadline and the date of completion of the merger.

Shares of Diablo Valley Bank common stock as to which the holder has not made a valid election prior to the election deadline, including as a result of revocation, will be deemed non-election shares. If it is determined that any purported cash election or stock election was not properly made, the purported election will be deemed to be of no force or effect and the holder making the purported election will be deemed not to have made an election for these purposes, unless a proper election is subsequently made on a timely basis.

*Letter of Transmittal.* Soon after the completion of the merger, but no later than the 5<sup>th</sup> business day following the effective date, the exchange agent will send a letter of transmittal to only those persons who were Diablo Valley Bank shareholders at the effective time of the merger and who have not previously submitted a form of election and properly surrendered shares of Diablo Valley Bank common stock to the exchange agent. This mailing will contain instructions on how to surrender shares of Diablo Valley Bank common stock (if these shares have not already been surrendered) in exchange for the merger consideration the holder is entitled to receive under the merger agreement.

If a certificate for Diablo Valley Bank common stock has been lost, stolen or destroyed, the exchange agent will issue the consideration properly payable under the merger agreement upon receipt of appropriate evidence as to that loss, theft or destruction, appropriate evidence as to the ownership of that certificate by the claimant, and appropriate and customary indemnification.

*After completion of the merger, there will be no further transfers on the stock transfer books of Diablo Valley Bank, except as required to settle trades executed prior to completion of the merger.*

#### **Withholding**

The exchange agent will be entitled to deduct and withhold from the cash consideration or cash in lieu of fractional shares payable to any Diablo Valley Bank shareholder the amounts the exchange agent is required to deduct and withhold under any federal, state, local or foreign tax law. If the exchange agent withholds any amounts, these amounts will be treated for all purposes of the merger as having been paid to the shareholders from whom they were withheld.

#### **Dividends and Distributions**

Until Diablo Valley Bank common stock certificates are surrendered for exchange, any dividends or other distributions declared after the effective time with respect to Heritage Commerce Corp common stock into which shares of Diablo Valley Bank common stock may have been converted will accrue but will not be paid. Heritage Commerce Corp will pay to former Diablo Valley Bank shareholders any unpaid dividends or other distributions, without interest, only after they have duly surrendered their Diablo Valley Bank stock certificates.

Prior to the effective time of the merger, Diablo Valley Bank and its subsidiaries may not declare or pay any dividend or distribution on its capital stock or repurchase any shares of its capital stock, other than dividends payable to holders of Diablo Valley Bank series A preferred stock in accordance with its terms.

#### **Representations and Warranties**

The merger agreement contains customary representations and warranties of Diablo Valley Bank and Heritage Commerce Corp relating to their respective businesses. With the exception of certain representations that must be true and correct in all material respects (or, in the case of specific representations and warranties regarding the capitalization of Diablo Valley Bank, true and correct except to a de minimis extent), no representation or warranty will be deemed untrue or incorrect as a consequence of the existence or absence of any fact, circumstance or event unless that fact, circumstance or event, individually or when taken together with all other facts, circumstances or events inconsistent with the representations and warranties, has had or is reasonably likely to have a material adverse effect on the ability of the company making the representation to consummate the merger, or on the business, results of operations or financial conditions of the company making the representation. In determining whether a material adverse effect has occurred or is reasonably likely, the parties will disregard effects resulting from (1) the economy in general, except to the extent that such changes have a disproportionate adverse effect on such party, (2) changes in the banking industry generally, except to the extent that such changes have a disproportionate adverse effect on such party, or (3) public disclosure of the merger. The representations and warranties in the merger agreement do not survive the effective time of the merger.

Each of Heritage Commerce Corp, Heritage Bank of Commerce and Diablo Valley Bank has made representations and warranties to the other regarding, among other things:

- corporate matters, including due organization and qualification;
- capitalization;
- authority relative to execution and delivery of the merger agreement and the absence of conflicts with, or violations of, organizational documents or other obligations as a result of the merger;
- required governmental filings and consents;

- the timely filing of reports with governmental entities, and the absence of investigations by regulatory agencies;
- financial statements, internal controls and accounting;
- broker's fees payable in connection with the merger;
- the absence of material adverse changes and undisclosed liabilities;
- legal proceedings;
- accuracy of bank regulatory reports;
- tax matters;
- compliance with applicable law;
- title to Assets; and
- the accuracy of information supplied for inclusion in this document and other similar documents.

In addition, Diablo Valley Bank has made other representations and warranties about itself to Heritage Commerce Corp and Heritage Bank of Commerce as to:

- intellectual property;
- real property;
- investment and loan portfolios;
- environmental liabilities;
- employee matters, including employee benefits;
- material contracts;
- insurance;
- allowance for loan loss;
- the receipt of a financial advisor's opinion;
- deposits;
- insider loans;
- trust Administration;
- employee benefit plans; and
- risk management instruments and derivatives.

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Heritage Commerce Corp also has made representations and warranties to Diablo Valley Bank regarding the accuracy of its reports filed with the Securities and Exchange Commission.

The representations and warranties described above and included in the merger agreement were made by each of Heritage Commerce Corp and Heritage Bank of Commerce, and Diablo Valley Bank to the other. These representations and warranties were made as of specific dates, may be subject to important qualifications and limitations agreed to by Heritage Commerce Corp and Heritage Bank of Commerce on one hand and Diablo Valley Bank on the other in connection with negotiating the terms of the merger agreement, and may have been included in the merger agreement for the purpose of allocating risk between Heritage Commerce Corp, Heritage Bank of Commerce and Diablo Valley Bank rather than

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to establish matters as facts. The merger agreement is described in, and included as an appendix to, this document only to provide you with information regarding its terms and conditions, and not to provide any other factual information regarding Diablo Valley Bank, Heritage Bank of Commerce, and Heritage Commerce Corp or their respective businesses. Accordingly, the representations and warranties and other provisions of the merger agreement should not be read alone, but instead should be read only in conjunction with the information provided elsewhere in this document and in the documents incorporated by reference into this document. See [Where You Can Find More Information](#) on page [\*].

### **Covenants and Agreements**

Diablo Valley Bank has undertaken customary covenants that place restrictions on it until the effective time of the merger. In general, Diablo Valley Bank agreed to (i) conduct its business in the ordinary course consistent with past practices and prudent banking practices, (ii) use reasonable efforts to maintain and preserve intact its business organization, employees and advantageous customer relationships, including retaining the services of key officers and employees, (iii) maintain its properties in good repair subject to ordinary wear and tear, (iv) maintain its insurance, (v) perform all of its obligations under existing contracts, (vi) comply with general accepted accounting principles or applicable law in the charge off of loans, (vii) maintain its allowance for loan and lease losses in accordance with past practice, and (viii) notify and consult with Heritage Commerce Corp before hiring an employee or purchasing an investment asset. Diablo Valley Bank further agrees that, with certain exceptions and except with Heritage Commerce Corp's prior written consent, Diablo Valley Bank will not, among other things, undertake the following extraordinary actions:

- take or fail to take any action which would reasonably be expected to have a material adverse effect on Diablo Valley Bank or adversely delay the ability of parties to obtain any necessary approvals;
- fail to take any action that would cause or permit the representations and warranties made in the merger agreement to be materially inaccurate at the time of closing of the merger;
- incur any indebtedness for borrowed money, other than in the ordinary course of business consistent with past practice;
- issue any shares of capital stock; adjust, split, combine or reclassify any capital stock; grant options under its stock option plan, make, declare or pay any dividend or make any other distribution on any capital stock (including payment of any stock dividends); except for the payments of dividends to holders of the series A preferred stock and except for redemption for the Diablo series A preferred stock as contemplated by the merger agreement;
- enter into or amend or renew any employment, consulting, severance or similar agreements with any director, officer or employee of Diablo or grant any salary or wage increase or increase any employee benefit, or grant any severance or termination payment except (i) in the ordinary course of business consistent with past practice, (provided that no such increase shall result in an annual adjustment of more than 5%), (ii) changes that are required by applicable law, (iii) to satisfy contractual obligations existing, for payment of bonuses and accrued on the financial statements for the year ended December 31, 2006, (iv) bonuses previously accrued on the Diablo Valley Bank financial statements or (v) for accrual of bonuses to option holders to compensate such holders for an adjustment to option exercise prices;
- hire any person, except to satisfy contractual obligations existing as of the date hereof and persons hired to fill any vacancies;
- enter into, establish, adopt or amend, or make any contributions to benefit plans, except as may be required by applicable law, to satisfy contractual obligations existing as of the date hereto, or otherwise permitted under the merger agreement;





- sell, transfer, pledge, encumber or otherwise dispose any of its assets or properties except upon prior notice to Heritage and pursuant to existing contracts or commitments or in the case of a pledge in the ordinary course of business consistent with past practice;
- acquire all or any portion of the assets or properties of any other person;
- make any capital expenditures other than those related to the establishment and completion of the new branch in Danville and other than capital expenditures in the ordinary course of business consistent with past practice in amounts not in excess of \$25,000;
- amend its articles of incorporation or the bylaws;
- implement or adopt any change in its accounting principles, practices or methods, other than as may be required by changes in laws or regulations or generally accepted accounting principles;
- except in the ordinary course of business consistent with past practice or as otherwise permitted under this Agreement, enter into any contract in excess of \$50,000, or terminate any material contract or amend or modify in any material respect any of its existing material contracts;
- enter into any settlement or similar agreement with respect to any action, suit, proceeding, order or investigation, which settlement, agreement or action involves payment of an amount in excess of \$50,000 and/or would impose any material restriction on the business of Diablo Valley Bank;
- except as required by applicable law or a governmental authority, (i) implement or adopt any material change in its interest rate and other risk management policies, procedures or practices, (ii) fail to follow in any material respect its existing policies or practices with respect to managing its exposure to interest rate and other risk, or (iii) fail to use commercially reasonable means to avoid any material increase in its aggregate exposure to interest rate risk;
- enter into a new material line of business;
- change its investment, underwriting, or asset liability management or other material banking policy;
- change its investment securities portfolio policy or the manner in which the portfolio is classified or reported; or invest in certain high-risk securities;
- take any action or omit to take any action that may result, in a material violation of the Bank Secrecy Act, or the anti-money laundering laws and regulations;
- enter into any derivatives contract;
- acquire (other than by foreclosure) any debt security or equity investment other than federal funds or United States Government securities or United States Government agency securities, with a term of one (1) year or less;
- make, renew or otherwise modify any loan, loan commitment, letter of credit or other extension of credit other than in the ordinary course of business consistent with past practice and with the consent of Heritage Commerce Corp for loans in excess of \$1.5 million;
- make any investment or commitment to invest in real estate or in any real estate development project, other than by way of foreclosure;

- forgive any loans to directors, officers or employees;
- adopt or enter into a plan of complete or partial liquidation, dissolution, merger, consolidation, restructuring, recapitulation or other reorganization;

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- file or cause to be filed any amended tax returns or claims for refund of taxes; or (i) prepare any return in a manner which is materially inconsistent with the past practices, (ii) incur any material liability for taxes other than in the ordinary course of business, or (iii) enter into any settlement or closing agreement with a taxing authority that materially affects or may materially affect the tax liability for any period ending after the closing date;
- fail to maintain insurance on its tangible assets and business consistent in all material respects with past practice;
- take any action that would, or is reasonably likely to, prevent or impede the merger from qualifying as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code;
- take any action that is intended or is reasonably likely to result in any of the conditions to the merger not being satisfied;
- enter into any transaction with any director or officer, except as permitted by the merger agreement or pursuant to any existing contract or obligations;
- make, acquire a participation in, reacquire an interest in a participation sold or sell any loan or lease that is not in compliance with its normal credit underwriting standards, policies and procedures or renew, extend the maturity of, or alter any of the material terms of any such loan or lease for a period of greater than six months;
- reduce any material accrual or reserve, including, without limitation, any contingency reserve, litigation reserve, tax reserve, or the allowance for loan and lease losses, by reversal or booking a negative provision, or change the methodology by which such accounts generally have been handled in past periods, unless required to do so by applicable accounting standards; and
- enter into any contract with respect to, or otherwise agree or commit to do, any of the foregoing.

Heritage Commerce Corp agrees that, except with Diablo Valley Bank's prior written consent, Heritage Commerce Corp will not, among other things, undertake the following extraordinary actions:

- take any action which would reasonably be expected to have a material adverse effect on or adversely delay the ability of the parties to obtain any necessary approvals of any governmental authority;
- amend its articles of incorporation in any respect that materially and adversely affects the rights and privileges attendant to the Heritage Commerce Corp common stock;
- take or agree to take, or make any commitment to take or adopt any resolutions of its Board of Directors in support of, any of the actions prohibited by the merger agreement;
- take any action or cause to be taken any action that would prevent or impede the merger from qualifying as a tax-free reorganization within the meaning of Section 368(a) of the Internal Revenue Code; and
- fail to substantially comply with and perform all material obligations and duties imposed upon it by all federal and state laws, and rules, regulations and orders imposed by federal, state and local governmental authorities.

The merger agreement also contains mutual covenants relating to the preparation of this document and the holding of the special meeting of Diablo Valley Bank shareholders, access to information of the other company and public announcements with respect to the transactions contemplated by the merger agreement. Diablo Valley Bank and Heritage Commerce Corp have also agreed to use their reasonable best efforts to take all actions needed to obtain necessary governmental and third party consents, and to



cause the merger of Diablo Valley Bank into Heritage Bank of Commerce. Diablo Valley Bank also agreed to cooperate with Heritage Commerce Corp to prepare for and facilitate the integration of the two banks following completion of the merger.

**Efforts of Diablo Valley Bank to Obtain the Required Shareholder Vote**

Diablo Valley Bank has agreed to hold a meeting of its shareholders as soon as is reasonably practicable for the purpose of obtaining shareholder approval of the merger. Diablo Valley Bank has agreed to recommend the approval of the merger agreement, the merger and the related transactions. The Diablo Valley Bank Board of Directors may not (i) withdraw, modify or amend, or propose to withdraw, modify or amend, to its recommendation, (ii) approve or recommend, or propose to approve or recommend, any acquisition proposal (as defined below), unless the acquisition proposal is a superior acquisition proposal (as defined below) and the board as complied with the other provisions in the merger agreement regarding the solicitation of other offers, Diablo Valley Bank terminates the merger agreement and pays Heritage Commerce Corp a termination fee. Notwithstanding the foregoing, the merger agreement requires Diablo Valley Bank to submit the merger agreement to a shareholder vote even if its Board of Directors no longer recommends approval of the merger agreement, in which event the board may communicate its basis for its lack of a recommendation to shareholders.

**Agreement Not to Solicit Other Offers**

Diablo Valley Bank also has agreed that it, its subsidiaries and their officers, directors and employees will not, directly or indirectly:

- solicit, initiate, encourage or facilitate any inquiries or proposals for any acquisition proposal (as defined below); or
- initiate or participate in any discussions or negotiations, furnish information, or enter into any agreement, regarding any acquisition proposal (as defined below).

However, prior to the special meeting, Diablo Valley Bank may consider and participate in discussions and negotiations with respect to a bona fide acquisition proposal if (1) it has first entered into a confidentiality agreement with the party proposing the acquisition proposal on terms comparable to the confidentiality agreement with Heritage Commerce Corp and (2) the Diablo Valley Bank Board of Directors determines in good faith (after consultation with independent financial advisors outside legal counsel) that the acquisition proposal is a superior acquisition proposal and failure to take these actions would cause it to violate its fiduciary duties.

Diablo Valley Bank has agreed:

- to notify Heritage Commerce Corp within 2 business days after it receives any acquisition proposal, or any request for nonpublic information relating to Diablo Valley Bank or any of its subsidiaries, and to provide Heritage Commerce Corp with relevant information regarding the acquisition proposal or request; and
- to keep Heritage Commerce Corp fully informed, on a current basis, of any material changes in the status and any material changes in the terms of any such acquisition proposal.

As used in the merger agreement, acquisition proposal means any of the following:

- any inquiry, proposal or offer (including any proposal to the Diablo Valley Bank shareholders) from any person or group relating to any direct or indirect acquisition or purchase of substantially all of the assets of Diablo Valley Bank or 20% or more of the Diablo Valley Bank common stock;

- any tender offer or exchange offer that, if consummated, would result in any person beneficially owning 20% or more of any class of equity securities of Diablo Valley Bank;
- any sale of any class of equity securities or securities convertible or exchangeable into or any agreement evidencing the right to acquire equity securities representing 20% or more of the voting power of Diablo Valley Bank;
- any merger, consolidation, business combination, recapitalization, liquidation, dissolution or similar transaction involving Diablo Valley Bank; or,
- a public announcement of another person (other than the merger described here) of an unsolicited bona fide proposal, plan or intention to do any of the foregoing.

As used in the merger agreement, superior acquisition means a bona fide binding written offer not solicited by or on behalf of Diablo Valley Bank made by a person to acquire all of the Diablo Valley Bank common stock pursuant to a tender offer, a merger or a sale of all of the assets of the Diablo:

- on terms which a majority of the members of the Diablo Valley Bank board (based on the written advice of an independent investment bank) reasonably determines in good faith to have a higher value than the consideration to be received by the Diablo Valley Bank shareholders in the transactions contemplated under the merger agreement (after any modification of the transactions contemplated hereby proposed by Heritage Commerce Corp);
- reasonably capable of being consummated (taking into account, among other things, all legal, financial, regulatory and other aspects of such proposal and the identity of the person making such proposal); and
- is not conditioned on obtaining any financing.

#### **Expenses and Fees**

Generally, each party has agreed to bear its own expenses in this transaction. Heritage Commerce Corp will bear the costs of preparing and filing this prospectus/proxy statement with the SEC (except for Diablo's legal and accounting fees). Heritage Commerce Corp will also bear the cost of printing and mailing these proxy materials.

Heritage Commerce Corp will pay the fees and costs related to the listing of the shares of Heritage Commerce Corp common stock for trading on the NASDAQ Global Select Market.

Each of Heritage Commerce Corp and Diablo Valley Bank will be responsible for all expenses incurred by it in connection with the negotiation and completion of the transactions contemplated by the merger agreement.

#### **Employee Matters**

Heritage Commerce Corp has agreed, with respect to the employees of Diablo Valley Bank at the effective time, that it will offer such employees participation in and coverage under employee benefits that are comparable, on an aggregate basis, to the plans generally in effect for similarly situated Heritage Commerce Corp employees. In recognition of the fact that the transition from Diablo Valley Bank employee plans to Heritage Commerce Corp plans may not occur upon completion of the merger, and may occur in stages, Heritage Commerce Corp and Diablo Valley Bank have agreed that continued participation and coverage under the Diablo Valley Bank employee benefit plans as existing immediately prior to completion of the merger will satisfy this obligation.

In addition, Heritage Commerce Corp has agreed, to the extent any Diablo Valley Bank employee becomes eligible to participate in Heritage Commerce Corp benefit plans following the merger:

- generally to recognize each employee's service with Diablo Valley Bank prior to the completion of the merger for purposes of eligibility to participate, vesting credits and benefit accruals under the Heritage Commerce Corp plans (but not for accrual of pension benefits or allocation of shares under the Heritage Commerce Corp ESOP Plan) to the same extent such service was recognized under comparable Diablo Valley Bank plans prior to completion of the merger; and
- to waive any exclusion for pre-existing conditions under any Heritage Commerce Corp medical, dental, disability or other health plans, to the extent such limitation would have been waived or satisfied under a corresponding Diablo Valley Bank plan in which such employee participated immediately prior to the effective time, and recognize any medical or health expenses incurred in the year in which the merger closes for purposes of applicable deductible, co-insurance and maximum out-of-pocket expense requirements under any medical, dental or other health plan of Heritage Commerce Corp.

However, Heritage Commerce Corp has no obligation to continue the employment of any Diablo Valley Bank employee or to provide any particular employee benefits for any period following the merger.

#### **Indemnification and Insurance**

The merger agreement provides that, upon completion of the merger, Heritage Commerce Corp will indemnify and hold harmless, and provide advancement of expenses to, all past and present officers and directors of Diablo Valley Bank and its subsidiaries in their capacities as such against all losses, claims, damages, costs, expenses, liabilities, judgments or amounts paid in settlement to the fullest extent provided under Diablo Valley Bank's and its subsidiaries' organizational documents and permitted by applicable law.

The merger agreement provides that Diablo Valley Bank shall purchase a tail period of five years after completion of the merger Diablo Valley Bank's current directors' and officers' liability insurance policies, except that the premium expense must not be greater than 150% of Diablo Valley Bank's current annual directors' and officers' liability insurance premium.

#### **Conditions to Complete the Merger**

Our respective obligations to complete the merger are subject to the fulfillment or waiver of certain conditions, including:

- the approval of the merger by Diablo Valley Bank shareholders;
- the absence of any judgment, decree, injunction, order, statute, rule or regulation prohibiting or preventing completion of the transactions contemplated by the merger agreement;
- the approval of the listing of Heritage Commerce Corp common stock to be issued in the merger on the NASDAQ Global Select Market, subject to official notice of issuance;
- the receipt and effectiveness of all governmental and other approvals, registrations and consents, and the expiration of all related waiting periods required to complete the merger;
- the effectiveness of the registration statement of which this document is a part with respect to the Heritage Commerce Corp common stock to be issued in the merger under the Securities Act and the absence of any stop order or proceedings initiated or threatened by the SEC for that purpose.





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Each of Heritage Commerce Corp's and Diablo Valley Bank's obligations to complete the merger is also separately subject to the satisfaction or waiver of a number of conditions including:

- the receipt by each of Heritage Commerce Corp and Diablo Valley Bank of a legal opinion with respect to certain United States federal income tax consequences of the merger;
- the accuracy of the representations and warranties of each other party in the merger agreement, subject to the materiality standard provided in the merger agreement, and the performance by each other party in all material respects of their obligations under the merger agreement and the receipt by each party of certificates from the other party to that effect;
- the absence of material adverse effect on the other party.

In addition, Heritage Commerce Corp's obligation to complete the merger is subject to the following conditions including:

- all approvals or consents of any governmental authority which are necessary to consummate the merger without any conditions which Heritage Commerce Corp deems, in its reasonable opinion, to materially adversely affect it or be materially burdensome;
- redemption by Diablo Valley Bank of its series A preferred stock for \$32.00 per share in cash and for no other consideration, and pursuant to its terms;
- the employment agreements, consulting agreements, termination agreements and non-compete agreements entered into as of the date of the merger agreement with certain key employees shall not have been revoked, terminated or disavowed;
- receipt by Diablo Valley Bank of certain third party consents;
- receipt of the resignations of each Diablo Valley Bank director;
- shareholders seeking appraisal rights shall not exceed 5% of the issued and outstanding shares of Diablo Valley Bank common stock;
- on the close of business on the last day of the month preceding the closing date, the tangible equity capital of Diablo Valley Bank satisfies (within 2%) the following targets, if the closing date is:

On or before March 31, 2007	\$18.3 million
After March 31, 2007 and on or before April 30, 2007	\$18.6 million
After April 30, 2007 and on or before May 31, 2007	\$18.9 million
After May 31, 2007	\$19.1 million

- for purposes of the merger agreement, tangible equity capital means shareholders' equity (including common stock, paid in capital and retained earnings and excluding the Diablo Valley Bank series A preferred stock) (x) minus goodwill and any other intangible assets, and (y) without giving effect to any impact from gains or losses on available for sale securities, and (z) without recognizing any change resulting from actions taken by Diablo Valley Bank permitted by the merger agreement or with the written consent of Heritage or any expenses incurred in connection with this merger agreement (the amounts paid for the redemption of the Diablo Valley Bank series A preferred stock will reduce tangible equity capital for purposes of this test);

- at the close of business on the last day of the month preceding the effective date of the merger, total deposits (excluding brokered deposits) of Diablo Valley Bank, calculated pursuant to applicable accounting requirements, shall not be less than 85% of the average of total deposits for Diablo

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Valley Bank for the six-month period ending on the last day of the same month in the preceding year;

- Diablo Valley Bank shall have amended or replaced its outstanding stock option agreements to the extent required to provide that none of the outstanding Diablo Valley Bank stock options provide for a deferral of compensation within the meaning of applicable provisions of the Internal Revenue Code.

We cannot provide assurance as to when or if all of the conditions to the merger can or will be satisfied or waived by the appropriate party. As of the date of this document, we have no reason to believe that any of these conditions will not be satisfied.

#### **Termination of the Merger Agreement**

Heritage Commerce Corp and Diablo Valley Bank can terminate the merger agreement if any of the following events occurs:

- if there has been a final judicial or regulatory determination that the merger agreement is not enforceable or denying a regulatory application;
- if the shareholders of Diablo Valley Bank fail to approve the merger agreement at their shareholders meeting;
- if other party breaches any representation, warranty, covenant or agreement and fails to cure the breach within 30 days after written notice from the other party; or
- after September 30, 2007, if the merger has not been consummated by then, unless the failure to consummate the merger was due to the failure of the party requesting termination to perform an obligation under the merger agreement.

Heritage Commerce Corp may terminate the merger agreement if:

- Diablo Valley Bank's Board of Directors fails to provide notice or solicit proxies for the special meeting, fails to recommend the merger, changes or plans to change its positive recommendation of the merger, approves or recommends an acquisition proposal other than the merger, enters or plans to enter into agreements for another acquisition proposal, or recommends that Diablo Valley Bank shareholders tender their shares in connection with an offer that is not made by Heritage Commerce Corp;
- Diablo Valley Bank breaches its obligations under the merger agreement with respect to the solicitation and consideration of offers other than the merger;
- Diablo Valley Bank exercises its rights with regard to the consideration of other acquisition proposals under the merger agreement and continues discussions with persons concerning an acquisition proposal for more than 15 business days after the date of such acquisition proposal;
- the average closing price of Heritage Commerce Corp common stock on the NASDAQ Global Select Market for 20 consecutive trading days ending on the 5th business day before the effective date of the merger is less than \$23.50.

Diablo Valley Bank may terminate the merger agreement if Diablo Valley Bank's Board of Directors authorizes Diablo Valley Bank, subject to complying with the terms of the merger agreement, to enter into a written agreement with respect to a superior acquisition proposal by a third party provided that:

- Diablo Valley Bank's Board of Directors complies with the provisions of the merger agreement relating to the non-solicitation of competing acquisition proposals and in responding to unsolicited acquisition proposals;
- before taking any action Diablo Valley Bank promptly gives Heritage Commerce Corp notice of its decision to take such action, the notice specifies the material terms and conditions of the superior acquisition proposal and identifies the person making such superior acquisition proposal, and Diablo Valley Bank gives Heritage Commerce Corp at least five business days to propose revisions to the merger agreement in response to the superior acquisition proposal and Diablo Valley Bank negotiates in good faith with Heritage Commerce Corp with respect to such proposed revisions;
- Diablo Valley Bank Board of Directors reasonably determines in good faith that it is necessary to terminate the merger agreement in order to comply with its fiduciary duties under applicable law; and
- Diablo Valley Bank pays a termination fee to Heritage Commerce Corp as described below.

If the merger agreement is terminated, it will become void, except that the provisions regarding payment of expenses, confidentiality, payment of any termination fees if applicable or any relevant general provisions of the merger agreement will continue in effect. Also, if the merger agreement is terminated due to a party's breach, the termination will not relieve the breaching party from its liability and the non-breaching party will retain all of its legal rights and remedies against the breaching party for its breach.

#### **Termination Fee**

Diablo Valley Bank is required to pay Heritage Commerce Corp a termination fee of \$3,380,000 relating to the merger under the following circumstances:

- if Heritage Commerce Corp terminates the merger agreement because Diablo Valley Bank's Board of Directors fails to recommend the merger, adversely alters or modifies its favorable recommendation, approves or recommends an acquisition proposal other than the merger, enters or plans to enter into agreements for another acquisition proposal, recommends that Diablo Valley Bank shareholders tender their shares in connection with an offer that is not made by Heritage Commerce Corp;
- if Heritage Commerce Corp terminates the merger agreement because Diablo Valley Bank breaches its obligations under the merger agreement with respect to the solicitation and consideration of offers other than the merger;
- if Diablo Valley Bank terminates the merger agreement in connection with the acceptance of a superior acquisition proposal by Diablo Valley Bank's Board of Directors that is deemed necessary to fulfill its fiduciary duties as discussed above;
- Diablo Valley Bank continues discussions for more than 15 business days with another person about an acquisition proposal;
- if there is a publicly known acquisition proposal other than the merger, and the merger agreement is later terminated because of Diablo Valley Bank's shareholders' failure to approve the merger or because the merger is not consummated in time because of Diablo Valley Bank's actions, and Diablo Valley Bank enters into an acquisition proposal within 6 months of the termination of the



merger agreement or completes an acquisition proposal within 12 months after termination of the merger agreement.

#### **Amendment, Waiver and Extension of the Merger Agreement**

Subject to applicable law, the parties may amend the merger agreement by action taken or authorized by their boards of directors or by written agreement. However, after any approval of the transactions contemplated by the merger agreement by the Diablo Valley Bank shareholders, there may not be, without further approval of those shareholders, any amendment of the merger agreement that reduces the amount or changes the form of the consideration to be delivered to the shareholders of Diablo Valley Bank in the merger.

At any time prior to the completion of the merger, each of us, by action taken or authorized by our respective Board of Directors, to the extent legally allowed, may:

- extend the time for the performance of any of the obligations or other acts of the other party;
- waive any inaccuracies in the representations and warranties of the other party; or
- waive compliance by the other party with any of the other agreements or conditions contained in the merger agreement.

#### **Resales of Heritage Commerce Corp Stock by Affiliates**

Shares of Heritage Commerce Corp common stock to be issued to Diablo Valley Bank shareholders in the merger have been registered under the Securities Act, and may be traded freely and without restriction by those shareholders not deemed to be affiliates (as that term is defined under the Securities Act) of Diablo Valley Bank. Any subsequent transfers of shares, however, by any person who is an affiliate of Diablo Valley Bank at the time the merger is submitted for a vote of the Diablo Valley Bank shareholders will, under existing law, require:

- the further registration under the Securities Act of the Heritage Commerce Corp stock to be transferred;
- compliance with Rule 145 promulgated under the Securities Act, which permits limited sales under certain circumstances; or
- the availability of another exemption from registration.

An affiliate of Diablo Valley Bank is a person who directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, Diablo Valley Bank. These restrictions are expected to apply to the directors and executive officers of Diablo Valley Bank and the holders of 10% or more of the outstanding Diablo Valley Bank common stock. The same restrictions apply to the spouses and certain relatives of those persons and any trusts, estates, corporations or other entities in which those persons have a 10% or greater beneficial or equity interest.

Heritage Commerce Corp will give stop transfer instructions to the exchange agent with respect to the shares of Heritage Commerce Corp common stock to be received by persons subject to these restrictions, and the certificates for their shares will be appropriately legended. Heritage Commerce Corp is not required to further register the sale of Heritage Commerce Corp common stock to be issued to affiliates of Diablo Valley Bank.

Each of the individuals who are affiliates of Diablo Valley Bank for purposes of Rule 145 under the Securities Act will deliver to Heritage Commerce Corp on or before the date of the special meeting a written agreement intended to ensure compliance with the Securities Act.

## ACCOUNTING TREATMENT

The merger will be accounted for as a purchase, as that term is used under generally accepted accounting principles, for accounting and financial reporting purposes. Under purchase accounting, the assets (including identifiable intangible assets) and liabilities (including executory contracts and other commitments) of Diablo Valley Bank as of the effective time of the merger will be recorded at their respective fair values and added to those of Heritage Commerce Corp. Any excess of purchase price over the fair values is recorded as goodwill. Financial statements of Heritage Commerce Corp issued after the merger would reflect these fair values and would not be restated retroactively to reflect the historical financial position or results of operations of Diablo Valley Bank.

## MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF THE MERGER

The following is a general discussion of the anticipated material United States federal income tax consequences to U.S. holders (as defined below) of Diablo Valley Bank common stock of the receipt of shares of Heritage Commerce Corp common stock and cash in exchange for Diablo Valley Bank common stock pursuant to the merger. This summary is based upon the provisions of the Internal Revenue Code of 1986, as amended (which we refer to in this document as the Code), applicable current and proposed United States Treasury Regulations, judicial authorities and administrative rulings and practice, all as in effect as of the date of this registration statement and all of which are subject to change, possibly on a retroactive basis.

For purposes of this discussion, the term U.S. holder means a beneficial owner of Diablo Valley Bank common stock that is for United States federal income tax purposes: (i) a citizen or resident of the United States; (ii) a corporation, or other entity taxable as a corporation for United States federal income tax purposes, created or organized in or under the laws of the United States or any state thereof or the District of Columbia; (iii) a trust if it (a) is subject to the primary supervision of a court within the United States and one or more United States persons have the authority to control all substantial decisions of the trust or (b) has a valid election in effect under applicable United States Treasury Regulations to be treated as a United States person; or (iv) an estate the income of which is subject to United States federal income tax regardless of its source.

Holders of Diablo Valley Bank common stock who are not U.S. holders may have different tax consequences than those described below and are urged to consult their own tax advisors regarding the tax treatment to them under United States and foreign tax laws.

The United States federal income tax consequence to a partner in an entity treated as a partnership, for United States federal income tax purposes, that holds Diablo Valley Bank common stock generally will depend on the status of the partner and the activities of the partnership. Partners in a partnership holding Diablo Valley Bank common stock should consult their own tax advisors.

This discussion assumes that a U.S. holder holds Diablo Valley Bank common stock as a capital asset within the meaning of Section 1221 of the Code. This discussion does not address all aspects of United States federal income taxation that may be relevant to a U.S. holder in light of its personal circumstances or to U.S. holders subject to special treatment under the United States federal income tax laws (for example, insurance companies, dealers or brokers in securities or currencies, traders in securities who elect mark-to-market accounting, tax-exempt organizations, financial institutions, mutual funds, partnerships or other pass-through entities (and persons holding Diablo Valley Bank common stock through a partnership or other pass-through entity), United States expatriates and shareholders subject to alternative minimum tax, U.S. holders who hold Diablo Valley Bank common stock as part of a hedging, straddle, conversion or other integrated transaction, a person whose functional currency for United States federal income tax purposes is not the U.S. dollar, U.S. holders who acquired their Diablo Valley Bank common stock through the exercise of employee stock options or other compensation arrangements or U.S. holders who

exercise appraisal rights under California law). In addition, the discussion does not address any aspect of foreign, state, local, estate or gift taxation that may be applicable to a U.S. holder.

*Holders of Diablo Valley Bank common stock are strongly urged to consult with their own tax advisors as to the tax consequences of the merger on their particular circumstances, including the applicability and effect of the alternative minimum tax and any state, local or foreign and other tax laws and of changes in those laws.*

### **Tax Consequences of the Merger Generally**

Heritage Commerce Corp and Diablo Valley Bank have structured the merger to qualify as a reorganization within the meaning of Section 368(a) of the Code. It is a condition to Heritage Commerce Corp's obligation to complete the merger that Heritage Commerce Corp receive an opinion of its counsel, Buchalter Nemer, a professional corporation, dated the closing date of the merger, substantially to the effect that the merger will be treated as a reorganization within the meaning of Section 368(a) of the Code. It is a condition to Diablo Valley Bank's obligation to complete the merger that Diablo Valley Bank receive an opinion of its counsel, Bingham McCutchen LLP, dated the closing date of the merger, substantially to the effect that the merger will be treated as a reorganization within the meaning of Section 368(a) of the Code. These opinions will be based on facts, representations and assumptions set forth in the opinions and representations set forth in certificates to be received from Heritage Commerce Corp and Diablo Valley Bank. None of the tax opinions given in connection with the merger or the opinions described below will be binding on the Internal Revenue Service, and neither Heritage Commerce Corp nor Diablo Valley Bank intends to request any ruling from the Internal Revenue Service as to the United States federal income tax consequences of the merger.

Consequently, no assurance can be given that the Internal Revenue Service will not assert, or that a court would not sustain, a position contrary to any of those set forth below. In addition, if any of the facts, representations or assumptions upon which those opinions are based is inconsistent with the actual facts, the United States federal income tax consequences of the merger could be adversely affected. It is assumed for purposes of the remainder of the discussion that the merger will qualify as a reorganization within the meaning of the Code. Based on this assumption, upon the exchange of Diablo Valley Bank common stock for a combination of Heritage Commerce Corp common stock and cash, a U.S. holder will generally recognize gain (but not loss) in an amount equal to the lesser of:

- the amount of gain realized (i.e., the excess, if any, of the sum of the cash and the fair market value of the Heritage Commerce Corp common stock a U.S. holder received over its tax basis in the Diablo Valley Bank common stock surrendered in the merger); and
- the amount of cash received in the merger (other than cash received instead of a fractional share of Heritage Commerce Corp common stock).

For this purpose, gain or loss must be calculated separately for each identifiable block of shares surrendered in the exchange, and a loss realized on one block of shares may not be used to offset a gain realized on another block of shares. If a U.S. holder has different bases or holding periods in respect of shares of Diablo Valley Bank common stock, a U.S. holder should consult its tax advisor prior to the exchange with regard to identifying the bases or holding periods of the particular shares of Heritage Commerce Corp common stock received in the merger.

Any recognized gain will generally be long-term capital gain if the U.S. holder's holding period with respect to the Diablo Valley Bank common stock surrendered is more than one year at the effective time of the merger. In some cases, where a U.S. holder actually or constructively owned Heritage Commerce Corp common stock immediately before the merger, such cash received in the merger could be treated as having the effect of the distribution of a dividend, under the tests set forth in Section 302 of the Code. These rules are complex and dependent upon the specific factual circumstances particular to each U.S. holder. Consequently, each U.S. holder that may be subject to those rules should consult its tax advisor as to the application of these rules to the particular facts relevant to such U.S. holder.



### **Tax Basis and Holding Period**

A U.S. holder's aggregate tax basis in the shares of Heritage Commerce Corp common stock received in the merger, including any fractional share interests deemed received by the U.S. holder under the treatment described below, will equal its aggregate adjusted tax basis in the Diablo Valley Bank common stock surrendered in the merger, increased by the amount of taxable gain, if any, recognized in the merger (including any portion of the gain that is treated as a dividend but excluding any gain or loss resulting from the deemed receipt and redemption of a fractional share interest described below) and decreased by the amount of any cash received in the merger (excluding any cash received instead of a fractional share interest). The holding period for the shares of Heritage Commerce Corp common stock received in the merger (including a fractional share interest deemed received and redeemed as described below) will include the holding period for the shares of Diablo Valley Bank common stock surrendered in the merger.

### **Cash Instead of a Fractional Share**

A U.S. holder who receives cash instead of a fractional share of Heritage Commerce Corp common stock will be treated as having received the fractional share of Heritage Commerce Corp common stock pursuant to the merger and then as having exchanged the fractional share of Heritage Commerce Corp common stock for cash in a redemption by Heritage Commerce Corp. In general, this deemed redemption will be treated as a sale or exchange, provided the redemption is not essentially equivalent to a dividend. The determination of whether a redemption is essentially equivalent to a dividend depends upon whether and to what extent the redemption reduces the U.S. holder's deemed percentage stock ownership of Heritage Commerce Corp. While this determination is based on each U.S. holder's particular facts and circumstances, the Internal Revenue Service has ruled that a redemption is not essentially equivalent to a dividend and will therefore result in sale or exchange treatment in the case of a shareholder of a publicly held company whose relative stock interest is minimal and who exercises no control over corporate affairs if the redemption results in even a minor reduction in the stock interest of the shareholder. As a result, the redemption of a fractional share of Heritage Commerce Corp common stock is generally treated as a sale or exchange and not as a dividend, and a U.S. holder generally will recognize capital gain or loss equal to the difference between the amount of cash received and the basis in its fractional share of Heritage Commerce Corp common stock as set forth above. This capital gain or loss generally will be long-term capital gain or loss if, as of the effective date of the merger, the holding period for the shares is greater than one year. The deductibility of capital losses is subject to limitations.

### **Information Reporting and Backup Withholding**

Cash payments received in the merger by a U.S. holder may, under certain circumstances, be subject to information reporting and backup withholding (currently at a rate of 28%) of the cash payable to the holder, unless the holder provides proof of an applicable exemption or furnishes its taxpayer identification number, and otherwise complies with all applicable requirements of the backup withholding rules. Any amounts withheld from payments to a U.S. holder under the backup withholding rules are not additional tax and will be allowed as a refund or credit against the U.S. holder's United States federal income tax liability, provided that the required information is timely furnished to the Internal Revenue Service.

### **Reporting Requirements**

A U.S. holder who receives shares of Heritage Commerce Corp common stock as a result of the merger will be required to retain records pertaining to the merger and will be required to file with its United States federal income tax return for the year in which the merger takes place a statement setting forth certain facts relating to the merger.

## APPRAISAL RIGHTS

Holders of Diablo Valley Bank common stock who do not wish to accept the merger consideration may dissent from the merger and thereby be entitled to certain dissenters' appraisal rights so long as such dissenting shareholders perfect their rights in accordance with Chapter 13 of the California General Corporation Law. Relevant excerpts of Chapter 13 are included as Appendix C. The following discussion is not a complete statement of the law relating to dissenters' rights and is qualified in its entirety by reference to Appendix C. This discussion and Appendix C should be carefully reviewed by any common shareholder who wishes to exercise dissenters' rights or who wishes to preserve the right to do so, since failure to comply with the procedures prescribed in Chapter 13 will result in the loss of dissenters' rights. Heritage Commerce Corp is not required to complete the merger if holders of more than 5% of the outstanding Diablo Valley Bank shares perfect their dissenters' rights.

If the merger is consummated, those common shareholders of Diablo Valley Bank who elect to exercise their dissenters' rights and who in a timely and proper fashion perfect such rights will be entitled to receive the fair market value of their shares in cash. Fair market value would be determined as of February 8, 2007, the day before the first announcement of the terms of the merger, and therefore would not include any appreciation or depreciation caused by the merger. On February 8, the Diablo Valley Bank Board of Directors reviewed the previous two months trading volume and prices for the Diablo Valley Bank common stock and determined that the fair value of Diablo Valley Bank common stock for this purpose was \$20.77.

In order to qualify for dissenters' rights, a Diablo Valley Bank common shareholder must not have voted in favor of the merger and must make a written demand on Diablo Valley Bank within 30 days after Diablo Valley Bank mails the notice of approval of the merger to shareholders. A shareholder who executes and returns an unmarked proxy will have his or her shares voted For the merger and, as a consequence, such shareholder will be foreclosed from exercising rights as a dissenting shareholder.

If the merger is approved, Diablo Valley Bank will, within ten days after the meeting, mail to any shareholder who did not vote for the merger a notice that the required shareholder approval of the merger was obtained. This notice of approval will state the price determined by Diablo Valley Bank to represent the fair market value of any dissenting shares and a brief description of the procedures to be followed by dissenting shareholders who wish to further pursue their statutory rights. The dissenting shareholder must deliver his or her share certificate for receipt by Diablo Valley Bank within 30 days after the date on which the notice of approval was mailed to the shareholder. Diablo Valley Bank will stamp or endorse the certificate with a statement that the shares are dissenting shares and return it to the dissenting shareholder. The statements in the notice of approval will constitute an offer by Diablo Valley Bank to purchase from its shareholders any dissenting shares at the price stated, but only if the merger is consummated. However, the determination by Diablo Valley Bank of fair market value is not binding on its shareholders.

A Diablo Valley Bank common shareholder who does not accept Diablo Valley Bank's determination of fair market value must send a written demand to Diablo Valley Bank, 387 Diablo Road, Danville, California 94526, Attention: Corporate Secretary. The written demand must state the number of common shares held of record by such shareholder which the shareholder demands that Diablo Valley Bank purchase for cash, and it must contain a statement of the amount which the shareholder claims to be the fair market value of the dissenting shares as of the day before announcement of the proposed merger. That statement will constitute an offer by the shareholder to sell his or her dissenting shares to Diablo Valley Bank at that price.

If Diablo Valley Bank and a dissenting shareholder do not agree on each other's proposed purchase price, the shareholder has the right, for six months following the mailing of the notice of approval, to file a lawsuit to have the fair market value determined by a court. The fair market value of dissenting shares determined by the court in those circumstances could be higher or lower than the amount offered by

Diablo Valley Bank in the notice of approval or the consideration provided for in merger agreement, and any such determination would be binding on the dissenting shareholders involved in the lawsuit and on Diablo Valley Bank. Any party may appeal from the judgment. However, the court action to determine the fair market value of shares will be suspended if litigation is instituted to test the sufficiency or regularity of the votes of the shareholders in authorizing the merger. No shareholder who has appraisal rights under Chapter 13 will have any right to attack the validity of the merger except in an action to test whether the number of shares required to authorize the merger has been legally voted in favor of the merger.

Dissenting Diablo Valley Bank shares may lose their status as such if any of the following events occurs:

- the merger is abandoned (in which case Diablo Valley Bank must pay on demand to dissenting shareholders who have initiated proceedings in good faith as provided under Chapter 13 all necessary expenses and reasonable attorneys fees incurred in such proceedings);
- the dissenting shares are transferred before being submitted to Diablo Valley Bank for endorsement;
- the dissenting shareholder withdraws his or her demand with the consent of Diablo Valley Bank; or,
- in the absence of agreement between the dissenting shareholder and Diablo Valley Bank as to the price of his or her shares, the Diablo Valley Bank shareholder fails to file suit or otherwise fails to become a party to such suit within six months following the mailing of the notice of approval.

The receipt of a cash payment for dissenting shares will result in recognition of gain or loss for federal and California state income tax purposes by dissenting shareholders. SHAREHOLDERS SHOULD BE AWARE THAT THE FAIR MARKET VALUE OF THEIR SHARES COULD BE GREATER THAN, THE SAME AS, OR LESS THAN THE MERGER CONSIDERATION. THE HOWE BARNES HOEFER & ARNETT OPINION IS NOT AN OPINION AS TO FAIR MARKET VALUE UNDER CHAPTER 13 OF THE CALIFORNIA GENERAL CORPORATIONS LAW.

**UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS**

These pro forma combined figures are arithmetical combinations of Heritage Commerce Corp's and Diablo Valley Bank's separate financial results modified to reflect certain acquisition-related adjustments. These presentations include an unaudited pro forma condensed combined balance sheet as of December 31, 2006 prepared under the assumptions that (i) the transaction is accounted for using the purchase method of accounting, (ii) 1,732,298 shares of Heritage Commerce Corp common stock are exchanged for Diablo Valley Bank common stock and \$15,012,876 of cash is exchanged for the remaining Diablo Valley Bank common stock, subject to adjustment as described in the merger agreement. For purposes of illustration, the pro forma combined figures have been calculated assuming that the average closing price of Heritage Commerce Corp common stock is \$26.27 (the average closing price for 20 trading days ending on the fifth trading day immediately before March 9, 2007) resulting in value to Diablo Valley Bank shareholders of \$24.19 per share consideration. As of December 31, 2006, there were 2,502,146 Diablo Valley Bank shares outstanding. For purposes of illustration, the pro forma combined figures have been calculated using an implied exchange ratio of .9208 shares of Heritage Commerce Corp common stock for each share of Diablo Valley Bank common stock. An unaudited pro forma condensed combined statement of income is also presented for the year ended December 31, 2006. The unaudited pro forma condensed combined balance sheet assumes the merger took place on December 31, 2006. The unaudited pro forma condensed combined statement of income gives effect to the merger as if it had occurred as of the beginning of the year. Certain assumptions associated with these statements are shown as footnotes to these pro forma financial statements.

The pro forma financial information includes purchase accounting adjustments to record the assets and liabilities of Diablo Valley Bank at their estimated fair values and is subject to further adjustments as additional information becomes available and as additional analyses are performed. The pro forma financial information is presented for illustrative purposes only and does not indicate the financial results of the combined company had the impact of business integration costs, possible revenue enhancements and expense efficiencies, among other factors, been considered.

We anticipate that the merger will provide the combined company with financial benefits that include reduced operating expenses. The unaudited pro forma condensed combined financial statements, while helpful in illustrating the financial characteristics of the combined company under one set of assumptions, do not reflect the benefits of expected cost savings or opportunities to earn additional revenue, nor do they reflect business integration costs which Heritage Commerce Corp expects to incur and, accordingly, do not attempt to predict or suggest future results.

Heritage Commerce Corp currently expects to consummate the merger in the second or third quarter of 2007, subject to the receipt of all required regulatory approvals and approval of shareholders of Diablo Valley Bank.

**HERITAGE COMMERCE CORP AND DIABLO VALLEY BANK**  
**Unaudited Pro Forma Condensed Combined Balance Sheet**  
**As of December 31, 2006**

	Heritage Commerce Corp	Diablo Valley Bank	Adjustments	Pro forma combined
(Dollars in thousands)				
<b>Assets:</b>				
Cash and due from banks	\$ 34,285	\$ 5,798	\$	\$ 40,083
Federal funds sold	15,100	27,715	(30,161)	(3) 12,654
Total cash and cash equivalents	49,385	33,513	(30,161)	52,737
Securities available for sale, at fair value	172,298	2,238	6,432	(10) 180,968
Securities held-to-maturity, at amortized cost (fair value of \$6,432 in 2006)		6,497	(6,497)	(10)
Loans held for sale, at lower of cost or market	17,234			17,234
Loans, net of deferred costs	725,754	199,412	(349)	(1) 924,817
Allowance for loan losses	(9,279)	(2,389)		(11,668)
Loans, net	716,475	197,023	(349)	913,149
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	6,113			6,113
Company owned life insurance	36,174			36,174
Premises and equipment, net	2,539	5,760	437	(1) 8,736
Intangibles			5,054	(2) 5,054
Goodwill			46,277	(1) 46,277
Accrued interest receivable and other assets	36,920	4,197	1,228	(4) 42,345
Total assets	\$ 1,037,138	\$ 249,228	\$ 22,421	\$ 1,308,787
<b>Liabilities and Shareholders Equity</b>				
<b>Liabilities:</b>				
Deposits				
Demand, noninterest bearing	\$ 231,841	\$ 45,709	\$	\$ 277,550
Demand, interest bearing	133,413	15,958		149,371
Savings and money market	307,266	100,979		408,245
Time deposits, under \$100	31,097	3,628	22	(1) 34,747
Time deposits, \$100 and over	111,017	57,941	(179)	(1) 168,779
Brokered deposits, \$100 and over	31,959			31,959
Total deposits	846,593	224,215	(157)	1,070,651
Notes payable to subsidiary grantor trusts	23,702			23,702
Securities sold under agreement to repurchase	21,800			21,800
Accrued interest payable and other liabilities	22,223	949	1,135	(5) 24,307
Total liabilities	914,318	225,164	978	1,140,460
Shareholders equity:				
Preferred stock		6,513	(6,513)	(6)
Common stock	62,363	17,155	28,352	(7) 107,870
Retained earnings	62,452	405	(405)	(8) 62,452
Accumulated other comprehensive loss	(1,995)	(9)	9	(9) (1,995)
Total shareholders equity	122,820	24,064	21,443	168,327
Total liabilities and shareholders equity	\$ 1,037,138	\$ 249,228	\$ 22,421	\$ 1,308,787

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**Notes to Pro Forma Condensed Combined Balance Sheet**

(1) The purchase price allocation for Diablo Valley Bank is summarized as follows:

	(Dollars in thousands)	
<b>Common stock consideration:</b>		
Common stock (using the average closing price for 20 trading days ending on the fifth trading day immediately before March 9, 2007 of \$26.27 for Heritage Commerce Corp common stock and the total stock consideration of 1,732,298 shares)	\$	45,507
	\$	45,507
<b>Cash consideration:</b>		
Cash paid to holders of Diablo Valley Bank common stock based on the average stock price described above	\$	15,013
Cash paid to settle Diablo Valley Bank stock options (represents the amount that Diablo Valley Bank stock option holders will receive at closing for the settlement of stock options)		7,522
Acquisition expenses		1,000
	\$	23,535
<b>Total purchase price</b>	<b>\$</b>	<b>69,042</b>
Allocated to net book value of Diablo Valley Bank's assets and liabilities	\$	24,064
<b>Adjustments:</b>		
Series A preferred stock redemption (207,061 shares at \$32.00 per share)		(6,626)
Tax benefit for settlement of Diablo Valley Bank stock options		3,159
Accrual of termination pay		(335)
Accrual of termination cost of data processing contract		(300)
Accrual of remaining professional fees related to the merger		(500)
Deferred tax benefit on above accrual adjustments (excluding non-deductible professional fees)		267
<b>Adjusted net book value of Diablo Valley Bank's assets and liabilities</b>		<b>\$19,729</b>
<b>To adjust Diablo Valley Bank's assets and liabilities to fair value:</b>		
Securities held to maturity		(65)
Loans		(349)
Time deposits, under \$100		(22)
Time deposits, over \$100		179
Land		437
Core deposit intangible		5,054
Net deferred tax liability on the above fair value adjustments		(2,198)
<b>Total fair value adjustment for Diablo's assets and liabilities</b>	<b>\$</b>	<b>3,036</b>
<b>Excess of purchase price over allocation to identifiable assets and liabilities goodwill</b>	<b>\$</b>	<b>46,277</b>

(2) To record core deposit intangible asset. Core deposit intangible will be amortized using an accelerated method over a 10-year period.

(3) To record redemption of series A preferred stock for \$6.6 million, cash consideration of \$15.0 million, \$7.5 million of stock option payout and acquisition costs of \$1.0 million, as follows:

Series A preferred stock redemption (207,061 shares at \$32.00 per share)	\$ 6,626
Estimated cash consideration for the acquisition	15,013
Estimated cash pay-out of stock options (assumes 647,125 outstanding stock options times (\$24.19 per share consideration \$12.567 weighted average exercise price of the options))	7,522
Estimated acquisition costs	1,000
	\$30,161

(4) To record the deferred tax benefit on the accrual of Diablo Valley Bank's termination pay; cost to terminate data processing contract; tax-deductible remaining professional fees of \$267,000; deferred tax liability on fair value adjustments to Diablo Valley Bank's assets and liabilities of \$2,198,000, and tax benefit of \$3,159,000 for settlement of Diablo Valley Bank stock options.

(5) To record the accrual of Diablo Valley Bank's termination pay obligations, cost to terminate Diablo Valley Bank data processing contract, and remaining professional fees as follows:

Estimated accrual of severance benefits	\$ 335
Accrual to termination cost for Diablo Valley Bank data processing contract	300
Accrual of remaining professional fees	500
	\$ 1,135

(6) Redemption of series A preferred stock.

(7) To eliminate Diablo Valley Bank's common stock and record the issuance of 1,732,298 shares of Heritage Commerce Corp's common stock at the average closing price for 20 trading days ending on the fifth trading day immediately before March 9, 2007 of \$26.27 as follows:

Elimination of Diablo Valley Bank common stock	\$ (17,155 )
Estimated stock consideration for the acquisition	45,507
	\$ 28,352

(8) To eliminate Diablo Valley Bank's retained earnings.

(9) To eliminate Diablo Valley Bank's accumulated other comprehensive loss.

(10) Assuming Heritage Commerce Corp will classify all acquired debt securities as available for sale.

**HERITAGE COMMERCE CORP AND DIABLO VALLEY BANK**  
**Unaudited Pro Forma Condensed Combined Statement of Income**  
**Year Ended December 31, 2006**

	Heritage	Diablo Valley Bank	Adjustments	Pro forma Combined
	(Dollars in thousands, except per share data)			
Interest income:				
Loans, including fees	\$ 61,859	\$ 13,900	\$ 300	(1) \$ 76,059
Securities, taxable	7,614	430		8,044
Securities, non-taxable	182			182
Interest bearing deposits in other financial institutions	132	116		248
Federal funds sold	3,170	1,113	(1,499 )	(6) 2,784
Total interest income	72,957	15,559	(1,199 )	87,317
Interest expense:				
Deposits	19,588	5,196	158	(2) 24,942
Notes payable to subsidiary grantor Trusts	2,310			2,310
Repurchase agreements and other	627	26		653
Total interest expense	22,525	5,222	158	27,905
Net interest income before provision for loan losses	50,432	10,337	(1,357 )	59,412
Provision for loan losses	(503 )	464		(39 )
Net interest income after provision for loan losses	50,935	9,873	(1,357 )	59,451
Noninterest income:				
Gain on sale of loans	4,008			4,008
Servicing income	1,860			1,860
Increase in cash surrender value of life Insurance	1,439			1,439
Service charges and fees on deposit accounts	1,335	173		1,508
Other	1,198	27		1,225
Total noninterest income	9,840	200		10,040
Noninterest expense:				
Salaries and employee benefits	19,414	4,130		23,544
Occupancy	3,110	508		3,618
Professional fees	1,688	186		1,874
Advertising and promotion	1,064	82		1,146
Client services	1,000			1,000
Low income housing investment losses and writedowns	995			995
Data processing	806	392		1,198
Furniture and equipment	517	271		788
Retirement plan expense	352			352
Amortization of intangibles			761	(3) 761
Other	5,322	877		6,199
Total noninterest expense	34,268	6,446	761	41,475
Income before income taxes	26,507	3,627	(2,118 )	28,016
Income tax expense	9,237	1,620	(890 )	(4) 9,967
Net income	17,270	2,007	(1,228 )	\$ 18,049
Preferred stock dividend		(331 )	331	(7)
Net income available to common shareholders	\$ 17,270	\$ 1,676	\$ (897 )	\$ 18,049
Earnings per share:				
Basic	\$ 1.47	\$ 0.67		\$ 1.34
Diluted	\$ 1.44	\$ 0.62		\$ 1.32
Weight average number of shares outstanding basic	11,725,671	2,491,488	(759,190 )	(5) 13,457,969
Weight average number of shares outstanding diluted	11,956,433	2,721,758	(989,460 )	(5) 13,688,731



**Notes to Pro Forma Condensed Combined Statement of Income**

For purposes of determining the effect of the merger on the statement of income, the following pro forma adjustments have been made as if the merger occurred at the beginning of the year.

- (1) To record accretion of the fair value adjustment of Diablo Valley Bank's loans using the interest method over approximately four years.
- (2) To record amortization and accretion of the fair value adjustments of Diablo Valley Bank's time deposits under \$100,000 and time deposits of \$100,000 or more using the interest method over a 3-year period and 1.25-year period, respectively.
- (3) To record amortization of core deposit intangible asset. The core deposit intangible will be amortized using an accelerated method over a 10-year period.
- (4) To record applicable income taxes at combined federal and state rate of 42%.
- (5) To record the elimination of Diablo Valley Bank's weighted average number of shares outstanding, the elimination of Diablo Valley Bank stock options, and the issuance of 1,732,298 shares of Heritage Commerce Corp's common stock for the acquisition transaction.
- (6) To record reduction of interest income on Federal funds sold using Heritage Commerce Corp's average Federal funds sold rate of 4.97% in 2006.
- (7) To eliminate preferred stock dividend due to redemption of Diablo Valley Bank's series A preferred stock.

## **DESCRIPTION OF DIABLO VALLEY BANK**

### **General**

Diablo Valley Bank commenced operations on October 20, 2003. Diablo Valley Bank is a California state chartered bank and its deposits are insured to the fullest extent allowable by the FDIC. Diablo Valley Bank engages in the general commercial banking business with an emphasis on serving the needs of small and medium size businesses, professionals, and the general public primarily in the Tri-Valley area of the San Francisco East Bay region. Diablo Valley Bank also assesses and attempts to meet the credit needs of all members of the communities served by Diablo Valley Bank in fulfillment of its responsibilities under the Community Reinvestment Act. See Regulation and Supervision Community Reinvestment Act. Diablo Valley Bank concentrates on providing customers with a high level of personalized service, while at the same time offering a full range of commercial banking services combined with the convenience of banking by courier and automated banking systems, including access to ATM services, internet banking, electronic cash management, and various loan and deposit services and products.

### **Areas Served**

Diablo Valley Bank serves the Tri-Valley area of the San Francisco East Bay region. This area bridges Contra Costa and Alameda counties and consists primarily of the cities of Danville, Alamo, Dublin, Pleasanton and Walnut Creek.

### **Business Strategy**

In marketing its services, Diablo Valley Bank capitalizes on its identity as a local, community bank, with officers, Directors and shareholders who have business and personal ties to the community. Small and medium-size businesses are targeted, as well as accounting, insurance, legal and medical professionals.

Diablo Valley Bank competes with other financial institutions in its service area through personalized service and personal contact with potential customers by Executive Officers, Directors, employees and shareholders. Additionally, employees of the bank participate in various community business and civic groups. Executive officers and directors are active members of the community who call personally on their business contacts and acquaintances in the Tri-Valley Area to become customers of Diablo Valley Bank.

Shareholders are not required to maintain any type of banking relationship with Diablo Valley Bank as a result of their purchase of shares of Diablo Valley Bank; however, shareholders are encouraged to maintain their banking relationship with Diablo Valley Bank and to provide business development referrals on an ongoing basis.

### **Deposit and Lending Activities**

Diablo Valley Bank offers a wide range of deposit accounts designed to attract commercial businesses, professionals, and residents in its primary service area. These accounts include personal and business checking accounts, money market accounts, time certificates of deposit, sweep accounts and specialized deposit accounts, including professional accounts, small business packaged accounts, and tiered accounts designed to attract larger deposits and Keogh and IRA accounts.

Diablo Valley Bank also offers a full complement of lending products designed to meet the specialized needs of its customers, including commercial and industrial lines of credit and term loans, credit lines to individuals, equipment loans, and real estate and construction loans. Diablo Valley Bank also offers consumer loans, including lines of credit, construction loans, home improvement loans and home equity lines of credit. Diablo Valley Bank offers loans in amounts which exceed Diablo Valley Bank's lending limits through participation agreements with correspondent banks and other financial institutions. On a selective basis, Diablo Valley Bank also offers loans for accounts receivable and inventory financing, and

equipment and expansion financing programs. Other services which Diablo Valley Bank offers include online banking services, direct payroll and social security deposits, letters of credit, safe deposit boxes, night depository facilities, notary services, travelers checks, lockbox, and banking by mail. Diablo Valley Bank offers a computerized internet banking system that enables its customers to view account information, transfer between accounts, access cash management services (including the initiation of wire transfers and ACH payments), make transfers between accounts, pay bills, make loan payments, pre-schedule deposit transfers and loan payments, and view both the front and back of cleared deposit items.

Management evaluates Diablo Valley Bank's services on an ongoing basis, and adds or deletes services based upon customer needs, competitive factors, and the financial and other capabilities of Diablo Valley Bank. Future services may also be significantly influenced by improvements and developments in technology and evolving state and federal regulations.

### **Competition**

The banking business in California generally, and in Diablo Valley Bank's service area in particular, is highly competitive with respect to both loans and deposits and is dominated by a number of major and other regional banks which have offices operating over wide geographic areas. Diablo Valley Bank competes for deposits and loans with these banks as well as with savings and loan associations, credit unions, mortgage companies, money market funds, stock brokerage firms, insurance companies, and other traditional and non-traditional financial institutions. Major financial institutions with offices in Diablo Valley Bank's service area include Bank of America, Wells Fargo Bank, Union Bank of California, U.S. Bank, and Washington Mutual Bank. Regional and independent financial institutions with offices in Diablo Valley Bank's service area include, among others, Bank of the West, Greater Bay Bank, Westamerica Bank, First Republic Bank and Mechanics Bank.

The major banks and some of the other institutions have the ability to finance extensive advertising campaigns and to shift their resources to regions or activities of greater potential profitability. Many of the competing banks and other institutions offer diversified financial services which may not be directly offered by Diablo Valley Bank. The major banks also have substantially more capital and higher lending limits than Diablo Valley Bank.

Diablo Valley Bank competes for customers' funds with governmental and private entities issuing debt or equity securities or other forms of investments which may offer different or higher yields than those available through bank deposits. Based upon statistics published by the FDIC, management estimates that as of June 30, 2006, there were 798 banking offices, including offices of major banks, regional and independent banks, and savings and loan associations within Alameda County and Contra Costa County.

Existing and future state and federal legislation could significantly affect Diablo Valley Bank's cost of doing business, its range of permissible activities, and the competitive balance among major, regional and independent banks, and other financial institutions. Management cannot predict the impact these matters may have on commercial banking in general or on the business of Diablo Valley Bank in particular.

To compete with the financial institutions operating in Diablo Valley Bank's service area, Diablo Valley Bank relies upon its independent status to provide flexibility and personalized service to its customers. Diablo Valley Bank emphasizes personal contacts with potential customers by Executive Officers, Directors and employees, develops local promotional activities, and seeks to develop specialized or streamlined services for customers. To the extent customers desire loans in excess of its lending limits or services not offered by Diablo Valley Bank, Diablo Valley Bank attempts to assist customers in obtaining such loans or other services through participations with other banks or assistance from correspondent banks.

**Properties**

Diablo Valley Bank owns a commercial property at 387 Diablo Road, Danville, California, where it recently completed construction of a 8,300 square-foot headquarters office containing its Danville branch and its administrative offices. Diablo Valley Bank has entered into a lease for its current branch in Pleasanton. Its leases for its former locations in Danville and Alamo have expired. The following table summarizes certain features of the Pleasanton lease:

Location	Square footage	Lease expiration date	Lease extension options
Pleasanton	4,100	October 31, 2010	One seven-year

**Securities Authorized for Issuance under Equity Plans**

The following table sets forth certain information as of December 31, 2006, concerning outstanding options and rights to purchase Diablo Valley Bank's common stock granted to participants in all of its equity compensation plans and the number of shares of common stock remaining available for issuance under such equity compensation plans.

Plan Category	Equity Compensation Plan Information		Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	
Equity compensation plans approved by security holders	647,125	\$ 12.57	68,225
Equity compensation plans not approved by security holders			
Total	647,125	\$ 12.57	68,225

**Security Ownership of Certain Beneficial Owners and Management**

The following table sets forth certain information regarding the beneficial ownership of Diablo Valley Bank's common stock as of December 31, 2006 by (i) each person who is known by Diablo Valley Bank to be the beneficial owner of more than five percent of the Diablo Valley Bank's outstanding common stock, (ii) each director of Diablo Valley Bank, and (iii) all directors and executive officers as a group.

Shares of common stock subject to options or warrants that are currently exercisable or exercisable within 60 days of the date of this proxy statement/prospectus and shares of common stock issuable upon conversion of series A preferred stock are considered outstanding and beneficially owned by the person holding the options for the purpose of computing the percentage ownership of that person but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.

Except as otherwise indicated below, each person named has sole voting and investment power with respect to the shares indicated, subject to community property laws. Except as indicated below, the address for each shareholder, director or named executive officer is Diablo Valley Bank, 387 Diablo Road, Danville, California 94526.

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This table assumes 2,502,146 shares of common stock outstanding as of December 31, 2006, and no exercise of outstanding options after that date.

Name of Beneficial Owner	Common Stock		Shares Beneficially Owned			Total Inc. Pref	Percent of class
	Number of Shares	Stock Option Shares	Total Shares	% of Class	Preferred		
Dennis M. Casagrande	83,000	35,300	118,300	4.66 %	0	118,300	4.66 %
Uri Eliahu	15,000	20,100	35,100	1.39 %	1,500	36,600	1.45 %
Randall D. Greenfield	0	9,600	9,600	0.38 %	0	9,600	0.38 %
William Keller	0	19,500	19,500	0.77 %	0	19,500	0.77 %
John J. Hounslow	75,000	87,500	162,500	6.27 %	12,756	175,256	6.73 %
Mark E. Lefanowicz	38,680	20,150	58,830	2.33 %	3,251	62,081	2.46 %
James A. Mayer	67,500	87,500	155,000	5.99 %	1,562	156,562	6.04 %
Alfred D. McKelvy, Jr.	15,000	12,800	27,800	1.11 %	1,300	29,100	1.16 %
Kenneth R. Mercer	15,000	10,200	25,200	1.00 %	0	25,200	1.00 %
Robert C. Philcox	37,500	20,150	57,650	2.29 %	3,251	60,901	2.41 %
Kenneth V. Stevens	75,000	36,750	111,750	4.40 %	11,502	123,252	4.83 %
Randy B. Williams	15,000	16,650	31,650	1.26 %	5,000	36,650	1.45 %
All directors and officers as a group (12 individuals)	436,680	376,200	812,880	28.24 %	40,122	853,002	29.23 %

The following table shows certain information as of December 31, 2006 regarding the beneficial ownership of Diablo Valley Bank series A preferred stock by each of the Diablo Valley Bank directors and executive officers, and for all directors and executive officers of Diablo Valley Bank as a group. Except as otherwise indicated below, all persons listed below have sole voting and investment power with respect to their shares of series A preferred stock, subject to community property laws.

This table assumes 207,061 shares of series A preferred stock outstanding as of December 31, 2006.

Name of Beneficial Owner	Series A Preferred Stock	
	Total Shares	% of Class
Dennis M. Casagrande	0	0.00 %
Uri Eliahu	1,500	0.72 %
Randall D. Greenfield	0	0.00 %
William Keller	0	0.00 %
John J. Hounslow	12,756	6.16 %
Mark E. Lefanowicz	3,251	1.57 %
James A. Mayer	1,562	0.75 %
Alfred D. McKelvy, Jr.	1,300	0.63 %
Kenneth R. Mercer	0	0.00 %
Robert C. Philcox	3,251	1.57 %
Kenneth V. Stevens	11,502	5.55 %
Randy B. Williams	5,000	2.41 %
All directors and officers as a group (12 individuals)	40,122	19.38 %

**DIABLO VALLEY BANK MANAGEMENT  
DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATION**

The following discussion provides additional information about the financial condition of Diablo Valley Bank (referred to in this section as Bank ) at December 31, 2006 and 2005 and results of operations for the years ended December 31, 2006, 2005 and 2004. The following analysis should be read in conjunction with the financial statements of Bank and the notes. Financial information related to the years ended December 31, 2006, 2005 and 2004 is derived from Bank s audited financial statements.

This discussion contains certain forward-looking information about us (See Disclosure Regarding Forward-Looking Statements on page [\*]).

**Critical Accounting Policies**

The discussion and analysis of Bank s results of operations and financial condition are based upon financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Bank s management to make estimates and judgments that affect the reported amounts of assets and liabilities, income and expense, and the related disclosures of contingent assets and liabilities at the date of these financial statements.

Bank believes these estimates and assumptions to be reasonably accurate; however, actual results may differ from these estimates under different assumptions or circumstances. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and valuation methods and expense attribution related to stock-based compensation.

**Allowance for Loan Losses**

The allowance for loan and lease losses represents Bank s best estimate of losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by credits to the allowance for loan losses for loans charged off, net of recoveries. Management evaluates the allowance for loan losses periodically. The allowance for loan losses is based upon management s assessment of various factors affecting the collectibility of the loans, including current economic conditions, past credit experience, delinquency status, the value of the underlying collateral, if any, and a continuing review of the portfolio of loans.

No assurance can be given that economic difficulties or other circumstances which would adversely affect our borrowers and their ability to repay outstanding loans will not occur which would be reflected in increased losses in our loan portfolio, which could result in actual losses that exceed reserves previously established.

**Stock-based Compensation**

Effective January 1, 2006, Bank adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment* (SFAS 123(R)). Under SFAS 123(R), compensation cost is recognized for all awards that vest subsequent to the date of adoption based on the grant-date fair value estimated in accordance with FASB Statement No. 123, *Accounting for Stock-Based Compensation* and SFAS 123(R). The grant-date fair value is estimated using the Black-Scholes option-pricing formula, which involves making estimates of the assumptions used, including the expected term of the option, expected volatility over the option term, expected dividend yield over the option term and risk-free interest rate. Because Bank s common stock has only been trading for a short period of time, Bank used an estimate of the expected volatility of an average of peer bank stocks in determining the impact of expected volatility on the

fair value of stock option awards. In addition, when determining the compensation expense to amortize over the vesting period, management makes estimates about the expected forfeiture rate of options.

## **Overview**

From the commencement of operations on October 20, 2003, the Bank has experienced significant growth in earning assets. However, as with most newly established banks, it incurred significant costs in connection with developing a customer base. As a result of costs associated with account development and personnel expenses, most newly established banks experience losses in their early years.

As the Bank has grown in asset size and has added earning assets, the losses diminished and the Bank reported its first profitable period of operations for the quarter ended March 31, 2005. For comparison, quarterly net losses for the year ended December 31, 2004 were \$815,000, \$642,000, \$466,000, \$179,000, respectively for the quarters ended March 31, 2004, June 30, 2004, September 30, 2004 and December 31, 2004. For the quarter ended March 31, 2005, the Bank reported net income of \$219,000.

For the year ended December 31, 2006, Bank reported net income of \$2,007,000, or \$0.62 per diluted share, compared with net income of \$2,353,000 or \$0.80 per diluted share, for the year ended December 31, 2005 and a net (loss) for the year ended December 31, 2004 of (\$2,102,000). The significant improvement in earnings since 2004 is attributed to the increased level of earning assets. The decrease in earnings from 2005 to 2006 is attributable primarily to the increase in the provision for income taxes from (\$878,000) in 2005 to \$1,620,000 in 2006. See Results of Operations, Net Income and Provision for Income Taxes below.

## **Results of Operations**

Bank's primary source of income is net interest income, which is the difference between interest income and fees derived from earning assets and interest paid on liabilities which fund those assets. Net interest income, expressed as a percentage of total average interest earning assets, is referred to as the net interest margin. Bank's net interest income is affected by changes in the volume and mix of interest earning assets and interest bearing liabilities. It is also affected by changes in yields earned on interest earning assets and rates paid on interest bearing deposits and other borrowed funds. Bank also generates noninterest income, including transactional fees and service charges on deposit accounts. Noninterest expenses consist primarily of employee compensation and benefits, occupancy and equipment expenses and other operating expenses. Bank's results of operations are also affected by its provision for loan losses. Results of operations may also be significantly affected by other factors including general economic and competitive conditions, mergers and acquisitions of other financial institutions within Bank's market area, changes in market interest rates, government policies, and actions of regulatory agencies.

### ***Net Income***

For the year ended December 31, 2006, Bank reported net income of \$2,007,000, or \$0.62 per diluted share, compared with net income of \$2,353,000 or \$0.80 per diluted share, for the year ended December 31, 2005 and a net (loss) for the year ended December 31, 2004 of (\$2,102,000).

### ***Net Interest Income and Net Interest Margin***

For the year ended December 31, 2006, net interest income was \$10,337,000 and the net interest margin was 4.99%. At December 31, 2006, approximately 79% of Bank's assets were comprised of net loans, 13% of Federal funds sold, cash and deposits with other financial institutions and 4% of investment securities. For 2005, net interest income was \$7,318,000 and the net interest margin was 4.73%.

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Net interest income increased by \$4,812,000 or 192% for the year ended December 31, 2005 compared to the year ended December 31, 2004. Net interest income was \$2,506,000 for the year ended December 31, 2004 and the net interest margin was 3.20%. The increase in net interest income and net interest margin in 2005 as compared to 2004 was due to the 97% increase in average earning assets and the increase in net interest margin resulting from the increase in the yield on earning assets being greater than the increase in the cost of funds.

For the year ended December 31, 2006, the cost of funding earning assets was 3.43% compared with 1.97% for the year ended December 31, 2005 and 1.21% for the year ended December 31, 2004. Bank has placed an emphasis on attracting business and professional accounts to increase the level of low cost deposits as a primary source of funding its earning assets. Noninterest bearing deposits (demand deposits) increased 186% from an average of \$14,774,000 during 2004 to an average of \$42,222,000 in 2006.

Bank has also experienced strong growth in savings and money market deposits, which increased 120% from an average of \$44,892,000 during 2004 to an average of \$98,635,000 in 2006.

Additionally, retail time deposits from the Bank's market area increased 260% from an average of \$7,337,000 during 2004 to an average of \$26,405,000 in 2006. During 2006, Bank acquired brokered time deposits, which averaged \$15,371,000, to meet its loan funding requirements.



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The following tables present condensed average balance sheet information for Bank, together with interest rates earned and paid on the various sources and uses of its funds for each of the periods presented. Nonaccrual loans are included in loans with any interest collected reflected on a cash basis.

	Year Ended December 31, 2006			2005			2004		
	Average Balance	Interest Income / Expense	Average Yield / Rate	Average Balance	Interest Income / Expense	Average Yield / Rate	Average Balance	Interest Income / Expense	Average Yield / Rate
<b>(Dollars in thousands)</b>									
Assets:									
Loans, gross	\$ 170,376	\$ 13,901	8.16 %	\$ 119,383	\$ 8,445	7.07 %	\$ 47,195	\$ 2,689	5.70 %
Securities & Investments	12,183	430	3.53 %	15,346	435	2.83 %	15,495	335	2.16 %
Interest bearing deposits in other banks	2,316	116	5.01 %	3,004	103	3.43 %	965	18	1.87 %
Federal funds sold	22,356	1,112	4.97 %	16,906	568	3.36 %	14,648	169	1.15 %
Total interest earning assets	207,231	15,559	7.51 %	154,639	9,551	6.18 %	78,303	3,211	4.10 %
Cash and due from banks	6,764			6,110			5,245		
Premises and equipment, net	4,492			3,690			3,478		
Other assets	2,023			560			284		
Allowance for loan losses	(2,131)	)		(1,089)	)		(345)	)	
Total assets	\$ 218,379			\$ 163,910			\$ 86,965		
Liabilities and shareholders equity:									
Deposits:									
Demand, interest bearing	\$ 11,542	\$ 79	0.68 %	\$ 7,730	25	0.32 %	\$ 5,927	\$ 49	0.83 %
Savings and money market	98,635	3,281	3.33 %	81,903	1,583	1.93 %	44,892	549	1.22 %
Time deposits, under \$100	2,965	115	3.88 %	2,560	64	2.50 %	942	13	1.38 %
Time deposits, \$100 and over	23,440	1,074	4.58 %	21,229	554	2.61 %	6,395	91	1.42 %
Brokered time deposits, \$100 and over	15,371	646	4.20 %						
Other borrowings	488	27	5.53 %	206	7	3.40 %	124	3	2.42 %
Total interest bearing liabilities	152,441	5,222	3.43 %	113,628	2,233	1.97 %	58,280	705	1.21 %
Demand, noninterest bearing	42,222			33,038			14,774		
Other liabilities	724			293			113		
Total liabilities	195,387			146,959			73,167		
Shareholders equity	22,992			16,951			13,798		
Total liabilities and shareholders equity	\$ 218,379			\$ 163,910			\$ 86,965		
Net interest income / margin		\$ 10,337	4.99 %		\$ 7,318	4.73 %		\$ 2,506	3.20 %

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The following table shows the change in interest income and interest expense and the amount of change attributable to variances in volume and rates.

	2006 vs. 2005 Changes Due To			Total
	Volume (Dollars in thousands)	Rate	Rate and Volume	
<b>Interest income:</b>				
Loans, gross	\$ 3,607	\$ 1,295	\$ 553	\$ 5,456
Securities & Investments	(90 )	107	(22 )	(5 )
Interest bearing deposits in other banks	(24 )	47	(11 )	13
Federal funds sold	183	273	88	544
Total interest earning assets	\$ 3,677	\$ 1,722	\$ 608	\$ 6,008
<b>Interest expense:</b>				
<b>Deposits:</b>				
Demand, interest bearing	\$ 12	\$ 28	\$ 14	\$ 54
Savings and money market	323	1,141	233	1,698
Time deposits, under \$100,000	10	35	6	51
Time deposits, \$100,000 and over	58	419	44	520
Brokered time deposits, \$100,000 and over			646	646
Other borrowings	10	4	6	20
Total interest bearing liabilities	\$ 413	\$ 1,628	\$ 948	\$ 2,989
Increase (decrease) in net interest income	\$ 3,264	\$ 95	\$ (340 )	\$ 3,019

**Provision for Loan Losses**

Bank maintains an allowance for loan losses for losses to absorb probable losses incurred in the loan portfolio. Charge-offs of loans (or reductions in the carrying values of nonperforming loans due to possible losses on their ultimate recovery) are charged against the allowance for loan losses, which is adjusted periodically to reflect changes in the volume of outstanding loans and the risk of potential losses due to a deterioration in the financial condition of borrowers or the value of property securing nonperforming loans, or changes in general economic conditions and other qualitative factors. Additions to the allowance for loan losses are made through a charge against income referred to as the provision for loan losses.

Bank's loan policy provides procedures designed to evaluate and assess the credit risk factors associated with its loan portfolio, to enable us to assess such credit risk factors prior to granting new loans and to evaluate the adequacy of the allowance for loan losses. Bank conducts an assessment of the allowance for loan losses on a monthly basis and undertakes a more critical evaluation quarterly. At the time of the quarterly review, the Board of Directors examines and formally approves the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and regulatory examination, estimated potential loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and non-accrual loans, trends in loan volume, effects of any changes in the lending policies and procedures, changes in lending personnel, current economic conditions at the local, state and national level, and a migration analysis of historical losses and recoveries for the prior eight quarters.

At December 31, 2006, Bank's allowance for loan losses totaled \$2,389,000, or 1.20% of outstanding loans, compared with an allowance for loan losses of \$1,925,000, or 1.31% of outstanding loans, at December 31, 2005 and \$750,000, or 0.80% of outstanding loans, at December 31, 2004. There have been no loans charged-off against the allowance for loan losses since the inception of Bank. For the years ended December 31, 2006, 2005 and 2004, the provision for loan losses was \$464,000, \$1,175,000 and \$680,000, respectively.

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The provision for loan losses is dependent on the increase in loans outstanding, the mix of loans within the portfolio and the volumes of loans past due or on nonaccrual status and other factors previously described. See Risk Factors-Bank Is Subject to Lending Risks on page [\*].

### *Noninterest Income*

Noninterest income is comprised primarily of service charges and other fees on deposit accounts. The following table sets forth the various components of the Bank's noninterest income:

	Year Ended December 31,			Increase (decrease) 2006 versus 2005		Increase (decrease) 2005 versus 2004	
	2006	2005	2004	Amount	%	Amount	%
	(Dollars in thousands)						
Service charges and fees on deposit accounts	\$ 173	\$ 76	\$ 20	\$ 97	127 %	\$ 56	280 %
Increase in cash surrender value of life insurance	7			7	NA		NA
Gain (loss) on sales of AFS securities	(20 )		1	(20 )	NA	(1 )	NA
Other	40	10	12	30	300 %	(2 )	17 %
<b>Total</b>	<b>\$ 200</b>	<b>\$ 86</b>	<b>\$ 33</b>	<b>\$ 114</b>	<b>133 %</b>	<b>\$ 53</b>	<b>158 %</b>

The increases in service charges are attributable to increases in the number of deposit accounts.

### *Noninterest Expense*

The following table sets forth the various components of the Bank's noninterest expenses:

	Year Ended December 31,			Increase (decrease) 2006 versus 2005		Increase (decrease) 2005 versus 2004	
	2006	2005	2004	Amount	Percent	Amount	Percent
	(Dollars in thousands)						
Salaries and employee benefits	\$ 4,130	\$ 2,864	\$ 2,267	\$ 1,266	44 %	\$ 597	26 %
Occupancy & equipment	779	738	795	41	6 %	(57 )	-7 %
Data processing and networking	391	316	102	75	24 %	214	209 %
Professional fees	186	183	236	3	2 %	(53 )	-23 %
Advertising and promotion	82	84	82	(2 )	-2 %	2	2 %
Communication	93	78	69	15	9 %	9	13 %
Insurance	65	61	60	4	7 %	1	2 %
Stationery & supplies	59	52	75	7	13 %	(23 )	-31 %
Other	661	378	275	283	75 %	103	37 %
<b>Total</b>	<b>\$ 6,446</b>	<b>\$ 4,754</b>	<b>\$ 3,961</b>	<b>\$ 1,692</b>	<b>36 %</b>	<b>\$ 793</b>	<b>20 %</b>

As Bank has increased its deposits and loans, it has incurred additional operating costs to support the growth including increased staffing and a commensurate increase in the cost of salaries and employee benefits. Additionally, in 2006, noninterest expenses included additional compensation expense related to the adoption of Statement of Financial Accounting Standards No. 123(R) in 2006, which totaled \$403,000.

Although certain economies of scale have been achieved and Bank anticipates continued improvement in this area, future operating costs may increase due to expansion activities, including providing new products, compliance with additional regulations and general economic conditions.

The following table indicates the percentage of noninterest expense in each category:

	2006		2005		2004	
	Amount (Dollars in thousands)	Percent Of Total	Amount	Percent of Total	Amount	Percent of Total
Salaries and employee benefits	\$ 4,130	64 %	\$ 2,864	60 %	\$ 2,267	57 %
Occupancy & equipment	779	12 %	738	16 %	795	20 %
Data processing and networking	391	6 %	316	7 %	102	3 %
Professional fees	186	3 %	183	4 %	236	6 %
Advertising and promotion	82	1 %	84	2 %	82	2 %
Communication	93	1 %	78	2 %	69	2 %
Insurance	65	1 %	61	1 %	60	1 %
Stationery & supplies	59	1 %	52	1 %	75	2 %
Other	661	10 %	378	7 %	275	7 %
Total	\$ 6,446	100 %	\$ 4,754	100 %	\$ 3,961	100 %

For the year ended December 31, 2006, noninterest expenses were 2.95% of average total assets and 61% of total revenue (total revenue is defined as net interest income plus noninterest income). This was a 3% decrease over 2005, while total revenue increased 44% during the same period.

Noninterest expenses were 2.90% of average total assets and 64% of total revenue in 2005 and 4.55% of average assets and 156% of total revenue in 2004.

#### ***Provision for Income Taxes***

Bank accrues income tax based on the anticipated tax rates during the financial period covered. The provision (benefit) for income taxes was \$1,620,000, (\$878,000) and \$800 for 2006, 2005 and 2004, respectively. As a result of the record of profitability achieved in 2005, Bank eliminated its valuation allowance resulting in a tax benefit of (\$878,000) in that year. In 2006, Bank recorded tax expense of \$1,620,000 resulting in an increase in tax expense of \$2,498,000 between the two years. Bank's effective tax rate in 2006 of 44.7% results from the federal statutory rate of 34%, state taxes at 7.2% and the non-deductibility of certain expenses.

#### **Investment Portfolio**

Securities classified as available-for-sale for accounting purposes are recorded at their fair or market value on the balance sheet. At December 31, 2006, investment securities comprised 4% of total assets. Available-for-sale investment securities carried at market value totaled \$2,238,000 at December 31, 2006 compared to original cost of \$2,253,000. Securities classified as held-to-maturity are carried at cost and totaled \$6,497,000. The market value of the held-to-maturity securities was \$6,432,000 at December 31, 2006. At December 31, 2005, investment securities comprised 8% of total assets. At December 31, 2005 and 2004, there were securities classified as held-to-maturity of \$7,493,000 and \$3,995,000 and securities classified as available-for-sale of \$7,123,000 and \$9,688,000 for the respective years. Changes in the fair market value of available-for-sale securities (e.g., unrealized holding gains or losses) are reported as other comprehensive income (loss), net of tax, and carried as accumulated comprehensive income or loss within shareholders' equity until realized.

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Bank utilizes the investment portfolio to manage liquidity and attract funding that requires collateralization. At December 31, 2006, investment securities with a book value of \$8,250,000, or 94% of the portfolio, were pledged to secure either time or local agency deposits from the State of California. At December 31, 2005, investment securities with a book value of \$10,595,000, or 72% of the portfolio, were pledged to secure time deposits from the State of California and repurchase agreements. At December 31, 2006, no securities were callable within one year.

**Investment Securities**

	<b>December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
	<b>(Dollars in thousands)</b>		
<b>Available-for-sale securities:</b>			
Federal agency securities	\$ 2,238	\$ 4,192	\$ 5,641
States and political subdivisions		1,424	1,976
Corporate bonds		1,507	2,071
	\$ 2,238	\$ 7,123	\$ 9,688
<b>Held-to-maturity:</b>			
Federal agency securities	\$ 4,997	\$ 5,993	\$ 1,995
States and political subdivisions	1,500	1,500	2,000
<b>Total</b>	<b>\$ 6,497</b>	<b>\$ 7,493</b>	<b>\$ 3,995</b>

The following table summarizes the carrying amounts and distribution of Bank's securities and the weighted average yields as of December 31, 2006.

**Maturity**

	<b>Within One Year</b>	<b>Yield</b>	<b>After One But</b>	<b>Within</b>	<b>Yield</b>	<b>Total</b>	<b>Yield</b>
	<b>Amount</b>		<b>Five Years</b>		<b>Amount</b>		
	<b>(Dollars in thousands)</b>						
<b>Available-for-sale:</b>							
Federal agency securities	\$ 1,984	4.42 %	\$ 252	2.82 %	\$ 2,238	4.24 %	
<b>Held-to-maturity:</b>							
Federal agency securities	\$ 3,998	3.96 %	\$ 999	3.83 %	\$ 4,997	3.93 %	
States and political subdivisions	1,500	2.77 %			1,500	2.77 %	
<b>Total</b>	<b>\$ 5,498</b>	<b>3.63 %</b>	<b>\$ 999</b>	<b>3.83 %</b>	<b>\$ 6,497</b>	<b>3.66 %</b>	

## Loan Distribution

The following table shows the composition of Bank's loan portfolio by amount and percentage of total loans for each major loan category at the dates indicated.

	December 31, 2006		2005		2004		2003	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
	(Dollars in thousands)							
Commercial	\$ 62,575	31 %	\$ 52,002	36 %	\$ 31,206	34 %	\$ 4,479	64 %
Real estate commercial	66,267	33 %	44,270	30 %	32,937	35 %		0 %
Real estate construction	44,808	22 %	26,737	18 %	16,663	18 %	1,089	15 %
Land development	20,207	11 %	17,402	12 %	9,335	10 %	1,107	16 %
Home equity	4,964	2 %	4,750	3 %	1,959	2 %	341	5 %
Consumer	1,037	1 %	1,227	1 %	1,239	1 %		0 %
Total loans	199,858	100 %	146,388	100 %	93,339	100 %	7,016	100 %
Deferred loan fees, net	(446 )		(320 )		(253 )		(29 )	
Allowance for loan losses	(2,389 )		(1,925 )		(750 )		(70 )	
Loans, net	\$ 197,023		\$ 144,143		\$ 92,336		\$ 6,917	

The following table presents commitments to fund as of December 31, 2006, 2005, and 2004.

	December 31,		
	2006	2005	2004
	(Dollars in thousands)		
Commitments to extend credit	\$ 89,619	\$ 70,080	\$ 57,433
Standby letters of credit	1,565	1,322	914
	\$ 91,184	\$ 71,402	\$ 58,347

## Loan Policies and Procedures

Bank's underwriting practices include an analysis of the borrower's management, current economic factors, the borrower's ability to respond and adapt to economic changes outside its direct control and verification of primary and secondary sources of repayment. Risk within the loan portfolio is managed through Bank's loan policies and underwriting. These policies are reviewed and approved annually by the Board of Directors.

- Management administers loan policy, ensures proper loan documentation, develops the methodology for monitoring loan quality and the level of the allowance for loan losses and reports on these matters to the Audit, ALCO and Loan Committees, and to the Board of Directors.
- The Board of Directors' ALCO Committee meets regularly and will review and make recommendations to the Board of Directors regarding the adequacy of the allowance for loan losses. The Committee also reviews management's asset and liability practices to ensure compliance with Bank's policies and procedures.
- The Board of Directors' Loan Committee is responsible for enforcement of loan policy and has additional responsibilities which include approving loans or loan relationships for a customer that, when considered in the aggregate, exceed management's level of loan authority for that customer. The Committee meets regularly and will evaluate problem assets and the adequacy of the allowance for loan losses.
- The Board of Directors' Audit Committee meets quarterly and is responsible for ensuring that an independent third party reviews the adequacy of the primary operating areas of the Bank, including the loan and asset and liability management practices and procedures, at least annually. The Committee will annually set scheduling and a budget for all external audits and reviews and then reviews all external audit reports performed for the Bank on a quarterly basis.



- The Board of Directors retains overall responsibility for all loan functions and must also review and approve loans or loan relationships that, when considered in the aggregate, exceed the Directors' Loan Committee level of loan authority.

Loan approvals are granted according to established policies, and lending officers are assigned approval authorities within their levels of training and experience. Interest rates reflect the risk inherent in loans and collateral is generally taken for purchase-money financing. Collateral may consist of accounts receivable, direct assignment of contracts, inventory, equipment and real estate. Unsecured loans may be made when warranted by the financial strength of the borrower. With the exception of single-family residential mortgage loans, the maximum loan term is generally five years. Most of Bank's loans bear interest at variable rates or include periodic repricing features. Guarantees are generally required to help assure repayment. Management believes that pricing is commensurate with risk for both new and existing customers.

### Nonperforming Assets

Nonperforming assets consist of nonperforming loans and other real estate owned. Nonperforming loans are those for which the borrower fails to perform under the original terms of the obligation and consist of nonaccrual loans, accruing loans 90 days or more past due and restructured loans.

	Nonaccrual, Past Due and Restructured Loans			
	December 31,			
	2006	2005	2004	2003
	(Dollars in thousands)			
Nonaccrual loans	\$ 157			
Accruing loans past due 90 days or more				
Total nonperforming loans	\$ 157			
Other real estate owned				
Total nonperforming assets	\$ 157			
Nonperforming loans to total loans	0.08	% 0	% 0	% 0
Nonperforming assets to total assets	0.06	% 0	% 0	% 0
Total loans and OREO	\$ 199,858	\$ 146,389	\$ 93,339	\$ 7,016

### Allocation of Allowance for Loan Losses

Bank maintains the allowance for loan losses to provide for probable losses in the loan portfolio. Additions to the allowance for loan losses are established through a provision charged to expense. All loans which are judged to be uncollectible are charged against the allowance while any recoveries are credited to the allowance. Bank's policy is to charge off any known losses at the time of determination. Any unsecured loan more than 90 days delinquent in payment of principal or interest and not in the process of collection is charged off in total. Secured loans are evaluated on a case by case basis to determine the ultimate loss potential to us subsequent to the liquidation of collateral. In those cases where we believe we are inadequately protected, a charge off will be made to reduce the loan balance to a level equal to the liquidation value of the collateral.

Bank's loan policy provides procedures designed to evaluate and assess the credit risk factors associated with the loan portfolio, to enable Bank to assess such credit risk factors prior to granting new loans and to evaluate the sufficiency of the allowance for loan losses. Bank conducts an assessment of the allowance on a monthly basis and undertakes a more critical evaluation quarterly. At the time of the quarterly review, the Board of Directors will examine and formally approve the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and regulatory examination, estimated potential loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and non-accrual loans, trends in loan volume, effects of any changes in lending policies and procedures, changes in lending personnel, current economic conditions at the local, state and national level and a migration analysis of historical losses and recoveries for the prior eight quarters.



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The following table sets forth an analysis of the allocation of the allowance for loan losses for the dates indicated.

	December 31, 2006		2005		2004		2003	
	Allowance (Dollars in thousands)	Percent of Loans in each group to total loans	Allowance	Percent of Loans in each group to total loans	Allowance	Percent of Loans in each group to total loans	Allowance	Percent of Loans in each group to total loans
Commercial	\$ 877	31 %	\$ 791	36 %	\$ 265	33 %	\$ 47	64 %
Real estate commercial	591	33 %	473	30 %	251	35 %		0 %
Real estate construction	635	22 %	402	18 %	163	18 %	13	16 %
Land development	172	10 %	173	12 %	52	10 %	8	16 %
Home equity	59	2 %	27	3 %	7	2 %	2	5 %
Consumer	55	1 %	59	1 %	12	1 %		0 %
Unallocated		0 %		0 %		0 %		0 %
Total	\$ 2,389	100 %	\$ 1,925	100 %	\$ 750	100 %	\$ 70	100 %

The following table shows the balance in the allowance for loan losses at the beginning of each year, activity in the allowance during the year and the resulting balance at the end of the year.

**Allowance for Loan Losses**

	2006 (Dollars in thousands)	2005	2004	2003
Balance, beginning of year	\$ 1,925	\$ 750	\$ 70	\$
Charge-offs:				
Commercial				
Real estate mortgage				
Real estate land and construction				
Home equity				
Consumer				
Total charge-offs				
Recoveries:				
Commercial				
Real estate mortgage				
Real estate land and construction				
Home equity				
Consumer				
Total recoveries				
Net charge-offs				
Provision for loan losses	464	1,175	680	70
Balance, end of year	\$ 2,389	\$ 1,925	\$ 750	\$ 70
<b>RATIOS:</b>				
Net charge-offs to average loans	0.00	% 0.00	% 0.00	% 0.00
Allowance for loan losses to average loans	1.40	% 1.61	% 1.59	% 2.35
Allowance for loan losses to total loans at end of period	1.20	% 1.31	% 0.80	% 1.00
Allowance for loan losses to nonperforming loans	1,525	% NA	NA	NA
Average total loans	\$ 170,376	\$ 119,383	\$ 47,195	\$ 2,973
Total loans, gross at period end	\$ 199,858	\$ 146,389	\$ 93,339	\$ 7,016
Total non-performing assets	\$ 157	\$	\$	\$

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The following table shows the distribution of maturities in the loan portfolio at December 31, 2006.

**Loan Maturities  
(by Regulatory Purpose)**

	Due in One Year or Less (Dollars in thousands)	Over One Year But Less than Five Years	Over Five Years	Total
Real estate construction & development	\$ 63,816	\$	\$ 2,593	\$ 66,409
Secured by residential properties	17,990	8,080		26,070
Secured by non-residential properties	16,208	30,206	8,377	54,791
Total real estate secured	98,014	38,286	10,970	147,270
Commercial & Industrial	45,151	4,650	1,970	51,772
Consumer	778	39		816
Total loans	\$ 143,943	\$ 42,975	\$ 12,940	\$ 199,858
Loans with variable interest rates	\$ 127,604	\$ 25,083	\$ 207	\$ 152,893
Loans with fixed interest rates	16,339	17,892	2,733	46,965
Total loans	\$ 143,943	\$ 42,975	\$ 12,940	\$ 199,858

**Deposits**

Deposits are Bank's primary source of funds. Bank employs business development officers to solicit commercial demand deposits. Bank focuses on obtaining deposits primarily from the communities it serves but occasionally may accept deposits from outside its market area.

The following table sets forth the average balances by deposit category and the interest cost for the periods indicated.

	Year Ended December 31 2006			2005			2004	
	Average Balance (Dollars in thousands)	Average Rate		Average Balance	Average Rate		Average Balance	Average Rate
Non-interest-bearing demand deposits	\$ 42,222	0 %	\$	\$ 33,039	0 %	\$	\$ 14,774	0 %
Interest-bearing demand deposits	11,542	0.68 %		7,730	0.32 %		5,927	0.83 %
Savings and money market deposits	98,635	3.33 %		81,903	1.93 %		44,892	1.22 %
Time deposits under \$100,000	2,965	3.88 %		2,560	2.50 %		942	1.38 %
Time deposits \$100,000 or over	23,440	4.58 %		21,229	2.61 %		6,395	1.42 %
Brokered time deposits \$100,000 or over	15,371	4.20 %						
Total deposits	\$ 194,175	2.68 %	\$	\$ 146,461	1.52 %	\$	\$ 72,930	0.96 %

The following table sets forth the maturities of time certificates of deposit of \$100,000 or more outstanding at December 31, 2006.

**Maturity of Time Deposits of \$100,000 or More**

	Balance (Dollars in thousands)	% of Total
Three months or less	\$ 32,970	57 %
Over three months through six months	14,978	26 %
Over six months through twelve months	9,786	17 %
Over twelve months	207	1 %
Total	\$ 57,941	100 %



### Interest Rate Sensitivity

Bank constantly monitors earning asset and deposit levels, developments and trends in interest rates, liquidity, capital adequacy and marketplace opportunities. Management responds to all of these to protect and possibly enhance net interest income while managing risks within acceptable levels as set forth in Bank's policies. In addition, alternative business plans and transactions are contemplated for their potential impact. This process is known as asset/liability management and is carried out by changing the maturities and relative proportions of the various types of loans, investments, deposits and borrowings in the ways described above.

The tool most commonly used to manage and analyze the interest rate sensitivity of a bank is known as a computer simulation model. To quantify the extent of risks in both Bank's current position and in transactions it might make in the future, Bank uses an outside service, Olsen Research Associates, to model the impact of different interest rate scenarios on net interest income. The hypothetical impact of both sudden (generally, an immediate change in interest rates of +/- 2.00%) and smaller incremental interest rate changes are modeled at least quarterly, representing the primary means Bank uses for interest rate risk management decisions.

### Interest Rate Risk Summary

Presented below, as of December 31, 2006 and 2005, is an analysis of the Bank's interest rate risk as measured by changes in the economic value of its equity (EVE), or the present value of equity over a one-year forecast time horizon, assuming a parallel shift in the treasury yield curve of 200 basis points:

Change in rates	2006		EVE as a % of Present Value of Assets		2005		EVE as a % of Present Value of Assets	
	\$ Change in EVE (Dollars in thousands)	% Change in EVE	EVE Ratio	Change (bp)	\$ Change in EVE	% Change in EVE	EVE Ratio	Change (bp)
+ 200 bp	\$ (428 )	-1.56 %	10.86 %	(2 )	\$ (1,339 )	-0.05 %	13.13 %	(47 )
0 bp		0.00 %	10.89 %	0		0.00 %	13.61 %	0
- 200 bp	\$ (333 )	-1.22 %	10.62 %	(27 )	\$ (503 )	-0.02 %	13.14 %	(46 )

Management believes that the EVE methodology overcomes three shortcomings of the typical maturity gap methodology. First, it does not use arbitrary repricing intervals and accounts for all expected future cash flows. Second, because the EVE method projects cash flows of each financial instrument under different interest rate environments, it can incorporate the effect of embedded options on an institution's interest rate risk exposure. Third, it allows interest rates on different instruments to change by varying amounts in response to a change in market interest rates, resulting in more accurate estimates of cash flows.

However, as with any method of gauging interest rate risk, there are certain shortcomings inherent to the EVE methodology. The model assumes interest rate changes are instantaneous parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short-term and long-term rates change by the same degree may also misstate historic rate patterns, which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or period to repricing will react in the same way to changes in rates. In reality, certain types of financial instruments may react in advance of changes in market rates, while the reaction of other types of financial instruments may lag behind the change in general market rates. Additionally, the EVE methodology does not reflect the full impact of annual and lifetime restrictions on changes in rates for certain assets, such as adjustable rate loans. When interest rates change, actual loan prepayments and actual early withdrawals from certificates may deviate significantly from the assumptions used in the

model. Finally, this methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients' ability to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

### Liquidity and Capital Resources

The Board of Directors recognizes that a strong capital position is vital to growth, continued profitability, and depositor and investor confidence.

Maintenance of adequate liquidity requires that sufficient resources be available at all times to meet cash flow requirements of Bank. Liquidity in a banking institution is required primarily to provide for deposit withdrawals and the credit needs of customers and to take advantage of investment opportunities as they arise. A bank may achieve desired liquidity from both assets and liabilities. Cash and deposits held in other banks, Federal funds sold, other short term investments, maturing loans and investments, payments of principal and interest on loans and investments, and potential loan sales are sources of asset liquidity. Deposit growth and access to credit lines established with correspondent banks and market sources of funds are sources of liability liquidity. Bank reviews its liquidity position on a regular basis based upon its current position and expected trends of loans and deposits. The policy of the Board of Directors is to maintain sufficient capital at not less than the well-capitalized thresholds established by banking regulators. Management believes that Bank maintains adequate sources of liquidity to meet its liquidity needs.

In June 2005 the Bank completed an offering of 207,061 shares of series A preferred stock, no par value, for \$32.00 per share. Net proceeds after offering costs of \$113,249 were \$6,512,703.

The following table summarizes risk-based capital, risk-weighted assets, and risk-based capital ratios of the Bank:

	December 31,		2004			
	2006	2005				
	(Dollars in thousands)					
<b>Capital components:</b>						
Tier 1 Capital	\$ 23,649	\$ 21,732	\$	13,029		
Tier 2 Capital	2,429	1,925		750		
Total risk-based capital	\$ 26,078	\$ 23,657	\$	13,779		
Risk-weighted assets	\$ 224,260	\$ 165,890	\$	115,670		
Average assets	\$ 242,768	\$ 191,544	\$	116,022		
					<b>Minimum Regulatory Requirements</b>	
<b>Capital ratios:</b>						
Total risk-based capital	11.63	% 14.26	%	11.91	%	8.00 %
Tier 1 risk-based capital	10.55	% 13.10	%	11.26	%	4.00 %
Leverage	9.74	% 11.35	%	11.23	%	4.00 %

Federal regulations establish guidelines for calculating risk-adjusted capital ratios and minimum ratio requirements. Under these regulations, banks are required to maintain a total risk-based capital ratio of 8.0% and Tier 1 risk-based capital (primarily shareholders' equity) of at least 4.0% of total qualifying capital. Bank had total and Tier 1 risk-based capital ratios of 11.6% and 10.6%, respectively, at December 31, 2006, and was well-capitalized under the regulatory guidelines. Bank's total and Tier 1 risk-based capital ratios were 14.3% and 13.1%, respectively, at December 31, 2005.

In addition, regulators have adopted a minimum leverage ratio standard for Tier 1 risk-based capital to total assets. The minimum ratio for top-rated institutions may be as low as 3%. However, regulatory agencies have stated that most institutions should maintain ratios at least 1 to 2 percentage points above the 3% minimum. As of December 31, 2006 and 2005, Bank's leverage ratio was 9.7% and 11.4%, respectively.

Capital levels for Bank remain above established regulatory capital requirements. Failure to meet minimum capital requirements can trigger mandatory and possibly additional discretionary actions by the regulators that, if undertaken, could have a material effect on Bank's financial statements and operations.

#### **DESCRIPTION OF HERITAGE COMMERCE CORP COMMON STOCK**

The authorized capital stock of Heritage Commerce Corp consists of 30,000,000 shares of common stock, no par value and 10,000,000 shares of preferred stock, no par value. As of December 31, 2006, there were 11,656,943 shares of common stock outstanding and no shares of preferred stock outstanding. In addition, options to acquire an additional 752,983 shares of Heritage Commerce Corp common stock were issued and outstanding.

The designations and powers, preferences and rights, and the qualifications, limitations or restrictions thereof, of each class of stock of Heritage Commerce Corp are described below.

#### **Common Stock**

The following is a summary of certain rights and provisions of our common stock. This summary does not propose to be complete and is qualified in its entirety by reference to our Articles of Incorporation, as amended, and the California Corporations Code.

*Dividends.* The holders of common stock shall be entitled to receive, subject to the applicable provisions of the California Corporations Code, such dividends as may be declared from time to time by the Board of Directors. See Comparative Market Prices and Dividends of page [\*].

*Dissolution.* In the event of a voluntary or involuntary liquidation, dissolution or winding up of Heritage Commerce Corp, after distribution in full of preferential amounts, if any, to be distributed to the holders of capital notes, if any, the holders of the common stock shall be entitled to receive all the remaining assets of Heritage Commerce Corp.

*Voting Rights.* Each share of common stock is entitled to one vote at any meeting of shareholders, except in the election of directors. California law provides that shareholders have cumulative voting rights in the election of directors, but only if at least one shareholder gives notice at the meeting of shareholders of his or her intention to cumulate his or her votes. Once such notice is given, every shareholder has the right to vote the number of shares owned for as many persons as there are directors to be elected, or to cumulate such votes and give one candidate as many votes as the number of directors multiplied by the number of shares owned equals, or to distribute such votes on the same principle among as many candidates as the shareholder deems appropriate.

*No Preemptive Rights.* Heritage Commerce Corp's common stock does not have preemptive rights; therefore, future shares of common stock may be offered to the investing public or to shareholders in the discretion of the Board of Directors.

*Vote Required to Amend Articles of Incorporation.* Heritage Commerce Corp's Articles of Incorporation may be amended at any regular or special meeting of the shareholders by the affirmative vote of a majority of the outstanding shares of common stock, unless the vote of the holders of a greater amount of stock is required by law.

### **Preferred Stock**

Heritage Commerce Corp's Articles of Incorporation authorize the Board of Directors to issue and sell up to 10,000,000 shares of preferred stock with such rights, preferences, privileges and restrictions as may be determined by the board, to divide the preferred stock shares into different series and determine the number of shares in each series. There are no shares of preferred stock issued and outstanding.

The transfer agent and registrar for Heritage Commerce Corp common stock is U.S. Stock Transfer.

### **DIFFERENCES IN RIGHTS OF SHAREHOLDERS**

The following is a general discussion of the material differences between the rights of Heritage Commerce Corp shareholders under the Heritage Commerce Corp articles and bylaws and applicable laws and the rights of Diablo Valley Bank shareholders under the Diablo Valley Bank articles and bylaws and applicable California law.

#### **General**

Heritage Commerce Corp is incorporated under and subject to all the provisions of the California General Corporation Law. Diablo Valley Bank is incorporated under and subject to all of the provisions of the California banking law and substantially all of the provisions of the California General Corporation Law. Upon consummation of the merger, except for those persons, if any, who dissent from the merger and perfect appraisal rights under the California law or receive all cash in the merger, the shareholders of Diablo Valley Bank will become shareholders of Heritage Commerce Corp.

#### **Declaration of dividends**

Under California law, the directors of Heritage Commerce Corp may declare and pay dividends upon the shares of its capital stock either (i) out of its retained earnings, or (ii) out of capital, provided the company would, after making the distribution, meet two conditions, which generally stated are as follows: (i) the corporation's assets must equal at least 125% of its liabilities; and (ii) the corporation's current assets must equal at least its current liabilities or, if the average of the corporation's earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of the corporation's interest expense for such fiscal years, then the corporation's current assets must equal at least 125% of its current liabilities.

Under the California banking law, Diablo Valley Bank may pay a dividend equal to its retained earnings or its net income from the last three years, whichever is less, or, with the prior approval of the California Commissioner of Financial Institutions, it may pay dividends up to the greatest of its retained earnings, its net income for its last fiscal year or its net income for its current fiscal year.

#### **Cumulative voting**

Shareholders of both Heritage Commerce Corp and Diablo Valley Bank are entitled to cumulate their votes for the election of directors. Cumulative voting allows a shareholder to cast a number of votes equal to the number of directors to be elected multiplied by the number of shares held in the shareholder's name on the record date. This total number of votes may be cast for one nominee or may be distributed among as many candidates as the shareholder desires. The candidates (up to the number of directors to be elected) receiving the highest number of votes are elected.

A California corporation that is a listed corporation may, by amending its articles or bylaws, eliminate cumulative voting for directors. Because Heritage Commerce Corp's common stock is quoted on the NASDAQ Global Select Market, it qualifies as a listed corporation. Such an amendment requires the

approval of holders of a majority of the outstanding shares of Heritage Commerce Corp common stock. Heritage Commerce Corp has no present plan to propose an amendment to eliminate cumulative voting.

### Classified Board of Directors

At present, the Heritage Commerce Corp bylaws and the Diablo Valley Bank bylaws provide directors will be elected for a one-year term at each Annual Meeting of Shareholders. A California corporation that is a listed corporation may, by amending its articles or bylaws, provide for a staggered or classified board of directors. Such an amendment requires the approval of holders of a majority of the outstanding shares of Heritage Commerce Corp common stock. Because Heritage Commerce Corp common stock is quoted on the NASDAQ Global Select Market, it qualifies as a listed corporation. Heritage Commerce Corp has no present plan to propose an amendment to provide for a classified board of directors.

### Dissenters' rights in mergers and other reorganizations

Under California General Corporation Law, a dissenting shareholder of a corporation participating in certain business combinations may, under varying circumstances, receive cash in the amount of the fair market value of his or her shares in lieu of the consideration he or she would otherwise receive under the terms of the transaction. The California General Corporation Law generally does not require dissenters' rights of appraisal with respect to shares which, immediately prior to the merger, are (i) listed on any national securities exchange certified by the Commissioner or (ii) listed on the Global Market System of the NASDAQ Stock Market. Heritage Commerce Corp common stock is listed on the NASDAQ Global Select Market. Heritage Commerce Corp shareholders generally have more limited dissenters' rights in connection with business combinations than do Diablo Valley Bank shareholders. Dissenters' rights are not available to the shareholders of a corporation surviving a merger if no vote of the shareholders of the surviving corporation is required.

### COMPARATIVE MARKET PRICES AND DIVIDENDS

Heritage Commerce Corp common stock is listed on the NASDAQ Global Select Market and Diablo Valley Bank common stock is listed on the Over-the-Counter Bulletin Board. The following table sets forth the high and low sales prices of shares of Heritage Commerce Corp common stock and Diablo Valley Bank common stock as reported on the NASDAQ Global Select Market and the Bulletin Board, respectively, and the quarterly cash dividends declared per share for the periods indicated.

	Heritage Commerce Corp Common Stock			Diablo Valley Bank Common Stock		
	High	Low	Dividend	High	Low	Dividend
<b>2005</b>						
First Quarter	\$ 19.39	\$ 17.65	\$	\$ 20.67	\$ 17.00	
Second Quarter	19.24	17.55		27.25	20.07	
Third Quarter	21.94	18.38		27.20	22.05	
Fourth Quarter	22.89	19.45		24.00	20.50	
<b>2006</b>						
First Quarter	25.00	21.08	.05	24.00	21.60	
Second Quarter	25.16	22.30	.05	22.25	21.60	
Third Quarter	24.95	22.55	.05	21.00	19.10	
Fourth Quarter	27.25	22.61	.05	22.50	19.10	

On February 8, 2007, the last full trading day before the public announcement of the merger agreement, the high and low sales prices of shares of Heritage Commerce Corp common stock as reported on the NASDAQ Global Select Market were \$27.25 and \$26.40, respectively. On [\*], the last full trading



day before the date of this document, the high and low sale prices of shares of Heritage Commerce Corp common stock as reported on the NASDAQ Global Select Market were \$[\*] and \$[\*], respectively.

On February 8, 2007, the high and low sales prices of shares of Diablo Valley Bank common stock as reported on the Over-the-Counter Bulletin Board were \$24.00 and \$22.00, respectively. On [\*], the high and low sale prices of shares of Diablo Valley Bank common stock as reported on the Over-the-Counter Bulletin Board were \$[\*] and \$[\*], respectively.

Heritage Commerce Corp shareholders and Diablo Valley Bank shareholders are advised to obtain current market quotations for Heritage Commerce Corp common stock and Diablo Valley Bank common stock. The market price of Heritage Commerce Corp common stock and Diablo Valley Bank common stock will fluctuate between the date of this document and the completion of the merger. No assurance can be given concerning the market price of Heritage Commerce Corp common stock or Diablo Valley Bank common stock before or after the effective date of the merger.

Diablo Valley Bank has not paid any cash dividends on its common stock since its inception, and does not contemplate paying dividends on its common stock in the future. It is anticipated that the earnings, if any, will be retained for the operation of its business. Regulatory restrictions limit the ability of Diablo Valley Bank to pay dividends to its shareholders, and limitations under the merger agreement described under The Merger Agreement Dividends and Distributions prevent Diablo Valley Bank from paying any dividends on Diablo Valley Bank common stock.

Heritage Commerce Corp's ability to declare dividends depends primarily upon dividends it receives from Heritage Bank of Commerce. Heritage Bank of Commerce's dividend practices in turn depend upon legal restrictions, Heritage Bank of Commerce's earnings, financial position, current and anticipated capital requirements, and other factors deemed relevant by Heritage Bank of Commerce's Board of Directors at that time.

Heritage Commerce Corp paid cash dividends totaling \$2.36 million, or \$0.20 per share in 2006 representing 14% of 2006 earnings. Heritage Commerce Corp's general dividend policy is to pay cash dividends within the range of typical peer payout ratios, provided that such payments do not adversely affect Heritage Commerce Corp's financial condition and are not overly restrictive to its growth capacity. However, no assurance can be given that earnings and/or growth expectations in any given year will justify the payment of such a dividend.

During any period in which Heritage Commerce Corp has deferred payment of interest otherwise due and payable on its subordinated debt securities, it may not make any dividends or distributions with respect to its capital stock. The ability of Heritage Commerce Corp's Board of Directors to declare cash dividends is also subject to statutory and regulatory restrictions which limit the amount available for cash dividends depending upon the earnings, financial condition and cash needs of Heritage Bank of Commerce, as well as general business conditions. Under California banking law, Heritage Bank of Commerce may pay dividends equal to its retained earnings or its net income from the last three years, whichever is less, or, with the prior approval of the California Commissioner of Financial Institutions, it may pay dividends up to the greatest of its retained earnings, its net income for its last fiscal year or its net income for its current fiscal year. The payment of any cash dividends by Heritage Bank of Commerce will depend not only upon Heritage Bank of Commerce's earnings during a specified period, but also on Heritage Commerce Bank meeting certain regulatory capital requirements.

Under California law, the directors of Heritage Commerce Corp may declare and pay dividends upon the shares of its capital stock either (i) out of its retained earnings, or (ii) out of capital, provided the company would, after making the distribution, meet two conditions, which generally stated are as follows: (i) the corporation's assets must equal at least 125% of its liabilities; and (ii) the corporation's current assets must equal at least its current liabilities or, if the average of the corporation's earnings before taxes

on income and before interest expense for the two preceding fiscal years was less than the average of the corporation's interest expense for such fiscal years, then the corporation's current assets must equal at least 125% of its current liabilities.

Additionally, the Federal Reserve Board policy regarding dividends provides that a bank holding company should not pay cash dividends exceeding its net income or which can only be funded in ways that weaken the bank holding company's financial health, such as by borrowing.

The FDIC and the California Department of Financial Institutions have authority to prohibit a bank from engaging in business practices that are considered to be unsafe or unsound. Depending upon the financial condition of a bank and upon other factors, the FDIC or California Department of Financial Institutions could assert that payments of dividends or other payments by a bank might be such an unsafe or unsound practice. The Federal Reserve Board has similar authority with respect to a bank holding company.

***Stock Repurchase Program***

In February 2006, Heritage Commerce Corp's Board of Directors authorized the purchase of up to \$10 million of its common stock, which represents approximately 455,000 shares, or 4%, of its outstanding shares at current market price. The share repurchase authorization is valid through June 30, 2007. Heritage Commerce Corp has and intends to continue to finance the repurchase of shares using its available cash. Shares may be repurchased by Heritage Commerce Corp in open market purchases or in privately negotiated transactions as permitted under applicable rules and regulations. The repurchase program may be modified, suspended or terminated by the Board of Directors at any time without notice. The extent to which Heritage Commerce Corp repurchases its shares and the timing of such repurchases will depend upon market conditions and other corporate considerations (including compliance with Heritage Commerce Corp's black out trading policies). Heritage Commerce Corp will suspend repurchases of its shares during the period commencing with the mailing of this proxy statement prospectus and ending on the date of the Diablo Valley Bank shareholder meeting and also during the period in which Heritage Commerce Corp's average closing price is used to determine the exchange ratio.

The following table provides information concerning Heritage Commerce Corp's repurchase of its common stock during 2006.

	<b>As of and for year ended December 31, 2006</b>
Total Shares Purchased	330,300
Average Per Share Price	\$ 23.88
Number of Shares as Part of Announced Plan or Program	330,300
Maximum Amount Remaining for Purchase Under Plan or Program	\$ 2,092,000

**LEGAL MATTERS**

The validity of the Heritage Commerce Corp common stock to be issued in connection with the merger will be passed upon for Heritage Commerce Corp by Buchalter Nemer, a professional corporation. Certain United States federal income tax consequences relating to the merger will also be passed upon for Heritage Commerce Corp by Buchalter Nemer, a professional corporation, and for Diablo Valley Bank by Bingham McCutchen LLP. Certain legal matters have been reviewed on behalf of Diablo Valley Bank by Bingham McCutchen LLP.

## EXPERTS

The consolidated financial statements of Heritage Commerce Corp as of December 31, 2006 and 2005 and for the years then ended, and Heritage Commerce Corp management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006, incorporated in this proxy statement/prospectus by reference from Heritage Commerce Corp's Annual Report on Form 10-K for the year ended December 31, 2006, have been audited by Crowe Chizek and Company LLP, an independent registered public accounting firm, as stated in its report thereon, which is incorporated by reference, and have been incorporated in reliance upon the report of such firm given upon its authority as experts in accounting and auditing.

The 2004 consolidated financial statements of Heritage Commerce Corp in this proxy statement prospectus incorporated by reference from Heritage Commerce Corp's Annual Report on Form 10-K for the year ended December 31, 2006 have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report, which is incorporated herein by reference, and have been incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The financial statements of Diablo Valley Bank as of December 31, 2006 and 2005, and for each of the years in the three-year period ended December 31, 2006, have been included herein in reliance upon the reports of Perry-Smith LLP, independent public accounting firm, and upon the authority of said firm as experts in accounting and auditing.

## PROPOSAL 2 AUTHORITY TO ADJOURN THE SPECIAL MEETING

If at the special meeting of shareholders we deem it necessary or appropriate to adjourn the special meeting in order to solicit additional proxies on the merger, we intend to move to adjourn the special meeting. In that event, we will ask our shareholders to vote only upon the adjournment proposal, and we will defer the vote on the proposal regarding the approval of the merger.

In this proposal, we are asking you to authorize the holder of any proxy solicited by our Board to vote in favor of granting discretionary authority to the proxy or attorney-in-fact to adjourn the special meeting to another time and place as deemed necessary or appropriate for the purpose of soliciting additional proxies on the merger. If the shareholders approve the adjournment proposal, we could adjourn the special meeting and any adjourned session of the special meeting and use the additional time to solicit additional proxies, including the solicitation of proxies from shareholders that have previously voted. No proxy that is specifically marked **AGAINST** approval of the merger agreement will be voted in favor of the adjournment proposal unless it is specifically marked **FOR** the adjournment proposal.

**Our Board recommends that you vote **FOR** the adjournment proposal.**

## OTHER MATTERS

Under the Diablo Valley Bank bylaws, business to be conducted at a special meeting of shareholders may only be brought before the meeting pursuant to a notice of meeting. Accordingly, no matters other than the matters described in this document will be presented for action at the special meeting or at any adjournment or postponement of the special meeting.

Diablo Valley Bank will hold a 2007 annual meeting of shareholders only if the merger is not completed.

**WHERE YOU CAN FIND MORE INFORMATION**

Heritage Commerce Corp has filed with the SEC a registration statement under the Securities Act that registers the distribution to Diablo Valley Bank shareholders of the shares of Heritage Commerce Corp common stock to be issued in connection with the merger. The registration statement, including the attached exhibits and schedules, contains additional relevant information about Heritage Commerce Corp and Heritage Commerce Corp common stock. The rules and regulations of the SEC allow us to omit certain information included in the registration statement from this document.

You may read and copy this information at the Public Reference Room of the SEC at 100 F Street, NE, Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the SEC's Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet website that contains reports, proxy statements and other information about issuers, like Heritage Commerce Corp, who file electronically with the SEC. The address of the site is <http://www.sec.gov>. The reports and other information filed by Heritage Commerce Corp with the SEC are also available at Heritage Commerce Corp's internet website. The address of the site is [www.heritagecommercecorp.com](http://www.heritagecommercecorp.com). We have included the web addresses of the SEC and Heritage Commerce Corp as inactive textual references only. Except as specifically incorporated by reference into this document, information on those websites is not part of this document.

The SEC allows Heritage Commerce Corp to incorporate by reference certain information in this document. This means that Heritage Commerce Corp can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is considered to be a part of this document, except for any information that is superseded by information that is included directly in this document.

This document incorporates by reference the documents listed below that Heritage Commerce Corp previously filed with the SEC. They contain important information about Heritage Commerce Corp and its financial condition.

**Heritage Commerce**

**Corp SEC Filings**

(SEC File No. 001-10521)

	<b>Period or Date Filed</b>
Current Report on Form 8-K	February 2, 2007
Current Report on Form 8-K	February 9, 2007
Current Report on Form 8-K	February 27, 2007
Current Report on Form 8-K	March 5, 2007
Current Report on Form 8-K	March 26, 2007
Annual Report on Form 10-K	Year ended December 31, 2006
Annual Report on Form 10K/A	Year ended December 31, 2006

The description of Heritage Commerce Corp common stock set forth in a registration statement filed pursuant to Section 12 of the Exchange Act and any amendment or report filed for the purpose of updating those descriptions

In addition, Heritage Commerce Corp also incorporates by reference additional documents that it files with the SEC under Sections 13(a), 13(c), 14 and 15(d) of the Securities Exchange Act of 1934, as amended, between the date of this document and the date of the Diablo Valley Bank special meeting. These documents include periodic reports, such as Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as proxy statements.

## Edgar Filing: HERITAGE COMMERCE CORP - Form S-4

Heritage Commerce Corp has supplied all information contained or incorporated by reference in this document relating to Heritage Commerce Corp, as well as all pro forma financial information, and Diablo Valley Bank has supplied all information relating to Diablo Valley Bank.

Documents incorporated by reference are available from Heritage Commerce Corp without charge, excluding any exhibits to those documents unless the exhibit is specifically incorporated by reference as an exhibit in this document. You can obtain documents incorporated by reference in this document by requesting them in writing or by telephone at the following address:

Heritage Commerce Corp  
150 Almaden Boulevard  
San Jose, California 95113  
Attention: Corporate Secretary  
Telephone: (408) 947-6900

*Diablo Valley Bank shareholders requesting documents should do so by [\*, 2007 to receive them before the special meeting.* You will not be charged for any of these documents that you request. If you request any incorporated documents from Heritage Commerce Corp, they will be mailed to you by first class mail, or another equally prompt means after receipt of your request.

Neither Heritage Commerce Corp nor Diablo Valley Bank has authorized anyone to give any information or make any representation about the merger or our companies that is different from, or in addition to, that contained in this document or in any of the materials that have been incorporated in this document. Therefore, if anyone does give you information of this sort, you should not rely on it. If you are in a jurisdiction where offers to exchange or sell, or solicitations of offers to exchange or purchase, the securities offered by this document or the solicitation of proxies is unlawful, or if you are a person to whom it is unlawful to direct these types of activities, then the offer presented in this document does not extend to you. The information contained in this document speaks only as of the date of this document unless the information specifically indicates that another date applies.

This document contains a description of the representations and warranties that each of Heritage Commerce Corp and Diablo Valley Bank made to the other in the merger agreement. Representations and warranties made by Heritage Commerce Corp, Diablo Valley Bank and other applicable parties are also set forth in contracts and other documents (including the merger agreement) that are attached or filed as exhibits to this document or are incorporated by reference into this document. These representations and warranties were made as of specific dates, may be subject to important qualifications and limitations agreed to between the parties in connection with negotiating the terms of the agreement, and may have been included in the agreement for the purpose of allocating risk between the parties rather than to establish matters as facts. These materials are included or incorporated by reference only to provide you with information regarding the terms and conditions of the agreements, and not to provide any other factual information regarding Diablo Valley Bank, Heritage Commerce Corp or their respective businesses. Accordingly, the representations and warranties and other provisions of the merger agreement should not be read alone, but instead should be read only in conjunction with the other information provided elsewhere in this document or incorporated by reference into this document.

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**INDEPENDENT AUDITOR'S REPORT**

The Shareholders and  
Board of Directors

Diablo Valley Bank

We have audited the accompanying balance sheet of Diablo Valley Bank (the "Bank") as of December 31, 2006 and 2005 and the related statements of operations, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2006. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Diablo Valley Bank as of December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, on February 8, 2007, the Bank entered into a definitive agreement to be acquired by Heritage Commerce Corp. As discussed in Notes 2 and 11 to the financial statements, the Bank adopted Statement of Financial Accounting Standards No. 123(revised 2004), *Share-Based Payment*, on January 1, 2006.

/s/ PERRY-SMITH LLP

Sacramento, California  
March 5, 2007

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**DIABLO VALLEY BANK**  
**BALANCE SHEET**  
**December 31, 2006 and 2005**

	2006	2005
<b>ASSETS</b>		
Cash and due from banks	\$ 5,798,408	\$ 4,320,552
Interest-bearing deposits in banks		3,450,000
Federal funds sold	27,715,000	20,570,000
Total cash and cash equivalents	33,513,408	28,340,552
Investment securities (Notes 3 and 7):		
Available for sale, at fair value	2,237,751	7,123,328
Held to maturity, at amortized cost	6,496,717	7,492,530
Loans, less allowance for loan losses of \$2,389,000 in 2006 and \$1,925,000 in 2005 (Notes 4, 9 and 13)	197,023,301	144,143,421
Bank premises and equipment, net (Note 5)	5,759,683	3,756,991
Accrued interest receivable and other assets	4,197,379	1,834,827
Total assets	\$ 249,228,239	\$ 192,691,649
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Deposits:		
Non-interest bearing	\$ 45,708,671	\$ 40,227,943
Interest bearing (Note 6)	178,506,627	125,309,206
Total deposits	224,215,298	165,537,149
Short-term borrowings (Note 7)		5,000,000
Accrued interest payable and other liabilities	949,436	405,653
Total liabilities	225,164,734	170,942,802
Commitments and contingencies (Note 9)		
Shareholders' equity (Note 10):		
Series A preferred stock no par value; liquidation preference \$32.00 per share; 10,000,000 shares authorized; 207,061 shares issued and outstanding in 2006 and 2005	6,512,703	6,512,703
Common stock no par value; 20,000,000 shares authorized; issued and outstanding 2,502,146 in 2006 and 2,482,946 in 2005	17,155,199	16,564,538
Accumulated earnings (deficit)	404,711	(1,271,385)
Accumulated other comprehensive loss, net of tax (Notes 3 and 12)	(9,108)	(57,009)
Total shareholders' equity	24,063,505	21,748,847
	\$ 249,228,239	\$ 192,691,649

The accompanying notes are an integral part of these financial statements.



**DIABLO VALLEY BANK**  
**STATEMENT OF OPERATIONS**  
**For the Years Ended December 31, 2006, 2005 and 2004**

	2006	2005	2004
<b>Interest income:</b>			
Interest and fees on loans	\$ 13,900,644	\$ 8,445,062	2,690,134
Interest on Federal funds sold	1,112,662	568,204	168,559
Interest on deposits in banks	116,267	103,344	17,612
Interest on investment securities	429,661	434,783	335,106
Total interest income	15,559,234	9,551,393	3,211,411
<b>Interest expense:</b>			
Interest on deposits (Note 6)	5,195,622	2,226,650	702,118
Interest on short-term borrowings (Note 7)	26,761	6,882	3,060
Total interest expense	5,222,383	2,233,532	705,178
Net interest income before provision for loan losses	10,336,851	7,317,861	2,506,233
Provision for loan losses (Note 4)	464,000	1,175,000	680,000
Net interest income after provision for loan losses	9,872,851	6,142,861	1,826,233
<b>Non-interest income:</b>			
Other income	200,006	86,009	33,370
<b>Non-interest expense:</b>			
Salaries and employee benefits (Notes 4 and 15)	4,129,808	2,863,775	2,266,435
Occupancy and equipment (Notes 5 and 9)	779,444	737,959	794,794
Other expenses (Note 14)	1,536,478	1,152,074	899,892
Total non-interest expense	6,445,730	4,753,808	3,961,121
Income (loss) before provision for income taxes	3,627,127	1,475,062	(2,101,518 )
Provision (benefit) for income taxes (Note 8)	1,619,733	(878,147 )	800
Net income (loss)	2,007,394	2,353,209	(2,102,318 )
Preferred stock dividend	(331,298 )	(165,649 )	
Income (loss) available to common shareholders	\$ 1,676,096	\$ 2,187,560	(2,102,318 )
Basic income (loss) per common share	\$ 0.67	\$ 0.88	(.85 )
Diluted income per common share	\$ 0.62	\$ 0.80	N/A
Weighted average number of shares outstanding basic	2,491,488	2,480,320	2,475,293
Weighted average number of shares outstanding diluted	2,721,758	2,749,927	N/A

The accompanying notes are an integral part of these financial statements.

**DIABLO VALLEY BANK**  
**STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY**  
**For the Years Ended December 31, 2006, 2005 and 2004**

	Series A Preferred Stock		Common Stock		Accumulated Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss) Net of Taxes	Total Shareholders Equity	Total Comprehensive Income (Loss)
	Shares	Amount	Shares	Amount				
Balance, January 1, 2004			2,474,996	\$ 16,477,538	\$ (1,356,627 )	\$ 8,610	\$ 15,129,521	
Comprehensive loss:								
Net loss					(2,102,318 )		(2,102,318 )	\$ (2,102,318 )
Other comprehensive loss:								
Net change in unrealized gains (losses) on available-for-sale investment securities (Note 12)						(81,693 )	(81,693 )	(81,693 )
Total comprehensive loss								\$ (2,184,011 )
Stock options exercised (Note 11)			1,500	10,000			10,000	
Balance, December 31, 2004			2,476,496	16,487,538	(3,458,945 )	(73,083 )	12,955,510	
Proceeds from sale of preferred stock, net of offering costs of \$113,249 (Note 10)	207,061	\$ 6,512,703					6,512,703	
Comprehensive income:								
Net income					2,353,209		2,353,209	\$ 2,353,209
Other comprehensive income:								
Net change in unrealized losses on available-for- sale investment securities (Note 12)						16,074	16,074	16,074
Total comprehensive income								\$ 2,369,283
Preferred dividends paid \$.80 per share					(165,649 )		(165,649 )	
Stock options exercised, including related tax benefits (Note 11)			6,450	77,000			77,000	
Balance, December 31, 2005	207,061	6,512,703	2,482,946	16,564,538	(1,271,385 )	(57,009 )	21,748,847	

(Continued)

**DIABLO VALLEY BANK**  
**STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (Continued)**  
**For the Years Ended December 31, 2006, 2005 and 2004**

	Series A Preferred Stock		Common Stock		Accumulated Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss) Net of Taxes	Total Shareholders Equity	Total Comprehensive Income (Loss)
	Shares	Amount	Shares	Amount				
Balance, December 31, 2005	207,061	\$ 6,512,703	2,482,946	\$ 16,564,538	\$ (1,271,385 )	\$ (57,009 )	\$ 21,748,847	
Comprehensive income:								
Net income					2,007,394		2,007,394	\$ 2,007,394
Other comprehensive income:								
Net change in unrealized losses on available-for-sale investment securities (Note 12)						47,901	47,901	47,901
Total comprehensive income								\$ 2,055,295
Preferred dividends paid \$1.60 per share					(331,298 )		(331,298 )	
Stock-based compensation expense (Notes 2 and 11)				403,461			403,461	
Stock options exercised, including related tax benefits (Note 11)			19,200	187,200			187,200	
Balance, December 31, 2006	207,061	\$ 6,512,703	2,502,146	\$ 17,155,199	\$ 404,711	\$ (9,108 )	\$ 24,063,505	
						<b>2006</b>	<b>2005</b>	<b>2004</b>
Disclosure of reclassification amount, net of taxes (Note 12):								
Unrealized holding gains (losses) arising during the year						\$ 36,382	\$ 16,074	\$ (80,707 )
Less: reclassification adjustment for net gains (losses) included in net income						(11,519 )		986
Net change in unrealized gains						\$ 47,901	\$ 16,074	\$ (81,693 )

The accompanying notes are an integral part of these financial statements.

**DIABLO VALLEY BANK**  
**STATEMENT OF CASH FLOWS**  
**For the Years Ended December 31, 2006, 2005 and 2004**

	2006	2005	2004
Cash flows from operating activities:			
Net income (loss)	\$ 2,007,394	\$ 2,353,209	\$ (2,102,318 )
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Provision for loan losses	464,000	1,175,000	680,000
Tax benefit from exercise of stock options	(37,600 )	(34,000 )	
Stock-based compensation	403,461		
Deferred tax provision (benefit)	(339,000 )	553,000	(862,000 )
FHLB stock dividend	(8,500 )		
Increase in cash surrender value of life insurance	(7,233 )		
Change in valuation allowance on deferred tax asset		(1,486,000 )	862,000
Depreciation, amortization and accretion	223,227	363,226	546,074
Increase in deferred loan origination fees, net	125,693	67,214	224,154
Loss (gain) on sale of investment securities, net	19,524		(986 )
Increase in accrued interest receivable and other assets	(421,554 )	(253,247 )	(248,349 )
Increase in accrued interest payable and other liabilities	581,382	230,073	195,563
Net cash provided by (used in) operating activities	3,010,794	2,968,475	(705,862 )
Cash flows from investing activities:			
Proceeds from the sale of available-for-sale investment securities	750,085		2,956,686
Proceeds from matured and called available-for-sale investment securities	4,185,000	4,340,000	4,140,000
Proceeds from matured and called held-to-maturity investment securities	1,000,000	1,500,000	1,375,000
Purchases of available-for-sale investment securities		(1,954,170 )	(15,521,221 )
Purchases of held-to-maturity investment securities		(4,990,838 )	(3,991,695 )
Net increase in loans	(53,469,573 )	(53,049,264 )	(86,322,968 )
Purchase of Federal Home Loan Bank stock	(613,700 )		
Purchase of bank-owned life insurance policies	(1,000,000 )		
Purchases of premises and equipment	(2,224,192 )	(304,952 )	(3,174,505 )
Proceeds from sale of premises and equipment	39,168		10,284
Purchases of software	(38,777 )		
Net cash used in investing activities	(51,371,989 )	(54,459,224 )	(100,528,419 )

(Continued)

**DIABLO VALLEY BANK**  
**STATEMENT OF CASH FLOWS (Continued)**  
**For the Years Ended December 31, 2006, 2005 and 2004**

	2006	2005	2004
Cash flows from financing activities:			
Net increase in deposits	58,678,149	57,483,326	81,714,794
Net proceeds from sale of preferred stock		6,512,703	
Payment of dividends on preferred stock	(331,298	) (165,649	)
(Decrease) increase in short-term borrowings	(5,000,000	)	5,000,000
Proceeds from exercise of stock options	149,600	43,000	10,000
Tax benefit from exercise of stock options	37,600	34,000	
Net cash provided by financing activities	53,534,051	63,907,380	86,724,794
Net change in cash and cash equivalents	5,172,856	12,416,631	(14,509,487
Cash and cash equivalents at beginning of period	28,340,552	15,923,921	30,433,408
Cash and cash equivalents at end of period	\$ 33,513,408	\$ 28,340,552	\$ 15,923,921
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest expense	\$ 4,754,015	\$ 2,172,312	\$ 692,802
Income taxes	\$ 1,935,000	\$	\$
Non-cash investing activities:			
Net change in unrealized loss on available-for-sale investment securities	\$ 81,188	\$ 23,542	\$ (81,693

The accompanying notes are an integral part of these financial statements.

**DIABLO VALLEY BANK  
NOTES TO FINANCIAL STATEMENTS**

**1. BUSINESS OF THE BANK**

*General*

On December 19, 2002, the organizers of Diablo Valley Bank (the Bank) filed an application with the Federal Deposit Insurance Corporation. The application was approved on May 23, 2003 and the Bank opened for business on October 20, 2003. The Bank provides products and services to customers who are predominately small and middle-market businesses, professionals and individuals residing in Danville, Pleasanton and the surrounding communities.

*Subsequent Event Pending Merger*

On February 8, 2007, the Bank and Heritage Commerce Corp (Heritage) entered into a definitive agreement for Heritage to acquire the Bank in a stock and cash-for-stock merger. The transaction is expected to be completed by mid-year 2007.

Under the terms of the agreement, the Bank's shareholders can elect to receive shares of Heritage common stock or cash for their shares of the Bank's common stock, subject to certain limitations. The exchange ratio (number of Heritage shares to be exchanged for each Diablo Valley Bank share) will be based on Heritage's average share price for each of the 20 consecutive trading days ending on the fifth trading day immediately before the closing date of the transaction (Heritage Closing Price).

The per share consideration will float within a band of \$23.00 to \$25.00 if the Heritage Closing Price is between \$24.55 and \$27.44. If the Heritage Closing Price is above \$27.44, the per share consideration will be increased to reflect one third of the increase in value of Heritage stock issued above \$27.44. If the Heritage Closing Price is below \$24.55 the aggregate amount of cash paid in the transaction will be increased sufficiently to maintain the per share consideration at \$23.00. Heritage has the right to terminate the transaction if the Heritage Closing Price is less than \$23.50.

The agreement contemplates that all Diablo Valley Bank options outstanding at closing will be cancelled and converted into the right to receive a lump sum cash payment equal to the intrinsic value of the options based on the per share consideration. In addition, the Bank's Series A Preferred Stock will be redeemed in full at \$32.00 per share prior to closing.

The completion of the merger is subject to various customary conditions, including receipt of requisite governmental approvals and the approval of our shareholders.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**DIABLO VALLEY BANK**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Reclassifications*

Certain reclassifications have been made to prior years' balances to conform to classifications used in 2006.

*Cash and Cash Equivalents*

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks, interest-bearing deposits in banks and Federal funds sold. Generally, interest-bearing deposits in banks are available on demand and Federal funds are sold for one day periods.

*Investment Securities*

Investment securities are classified into the following categories:

- Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.
- Held-to-maturity securities, which management has the positive intent and ability to hold to maturity, are reported at amortized cost and adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. There were no transfers between categories in 2006, 2005 or 2004.

Gains and losses on the sale of securities are computed using the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums.

Investment securities are evaluated for impairment at least quarterly, and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the issues for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

*Loans*

Loans are stated at principal balances outstanding. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectibility of interest and principal is in serious doubt, loans are placed on nonaccrual status and

**DIABLO VALLEY BANK**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectibility of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. An impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective rate or, as a practical matter, at the loan's observable market price or the fair value of collateral if the loan is collateral dependent.

Substantially all loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

*Allowance for Loan Losses*

The allowance for loan losses is maintained to provide for losses related to impaired loans and other losses that can be expected to occur in the normal course of business. The determination of the allowance is based on estimates made by management, to include consideration of the character of the loan portfolio, specifically identified problem loans, potential losses inherent in the portfolio taken as a whole and economic conditions in the Bank's service area.

Classified loans and loans determined to be impaired are evaluated by management for specific risk of loss. In addition, reserve factors are assigned to currently performing loans based on management's assessment of the following for each identified loan type: (1) inherent credit risk, (2) historical losses and, (3) where the Bank has not experienced losses, the loss experience of peer banks. These estimates are particularly susceptible to changes in the economic environment and market conditions.

The Director's Loan Committee reviews the adequacy of the allowance for loan losses at least quarterly, to include consideration of the relative risks in the portfolio, current economic conditions and other factors. The allowance is adjusted based on that review if, in the judgment of the Director's Loan Committee and management, changes are warranted.

The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. The allowance for loan losses at December 31, 2006 and 2005 reflects management's estimate of probable losses in the portfolio.

*Bank Premises and Equipment*

Bank premises and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be three to five years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in



**DIABLO VALLEY BANK**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

income for the period. The cost of maintenance and repairs is charged to expense as incurred. Management evaluates premises and equipment for financial impairment of events as changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

*Income Taxes*

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between reported amounts of assets and liabilities and their tax basis. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax asset will not be realized. On the balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

*Earnings (Loss) Per Share*

Basic earnings (loss) per share (EPS), which excludes dilution, is computed by dividing income (loss) available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options and convertible preferred stock, result in the issuance of common stock which shares in the earnings (losses) of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options and the if-converted method is applied to determine the dilutive effect of convertible preferred stock in computing diluted EPS. Convertible preferred stock is antidilutive whenever the amount of the dividend declared in or accumulated for the current period per common share obtainable on conversion exceeds basic EPS. Diluted EPS is not presented when a net loss occurs because the conversion of potential common stock is antidilutive.

In 2006 and 2005, the convertible preferred stock was antidilutive and therefore both basic EPS and diluted EPS were based on net income available to common shareholders. Furthermore, the change in the weighted average shares outstanding used in the computation of diluted EPS in 2006 and 2005 results solely from the effect of outstanding stock options.

*Stock-Based Compensation*

At December 31, 2006, the Bank had one stock-based compensation plan, the Diablo Valley Bank Stock Option Plan, which is described more fully in Note 11.

Effective January 1, 2006, the Bank adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123(R)), using the modified prospective transition method, which requires recognizing expense for options granted prior to the adoption date equal to fair value of the unvested amounts over their remaining vesting period, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, *Accounting for Stock Based Compensation*, and compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair values estimated in accordance with the provisions of SFAS 123(R). Prior to January 1, 2006, the Bank accounted for these plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations ( APB 25 ). No stock-based compensation cost is reflected in net income prior to January 1, 2006, as all options granted under these

**DIABLO VALLEY BANK**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

plans had an exercise price equal to the market value of the underlying common stock on the date of the grant.

SFAS 123(R) requires the cash flows from tax benefits that result from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as a cash flow from financing activities in the statement of cash flows.

In December 2005, the Bank accelerated the vesting of all previously unvested stock options granted to outside directors. The pro forma net earnings and earnings per share information for the year ended December 31, 2005, presented in the following table, reflects the acceleration. No stock-based compensation cost is reflected in net income as a result of the acceleration of the vesting as it is expected that the directors whose options were accelerated will remain with the Bank through the original vesting period.

The following table illustrates the pro forma effect on net income and earnings per share as if the Bank had applied the fair value recognition provisions of SFAS 123 to options granted under the Bank's stock option plans in all periods presented.

	2005	2004
Net income (loss) available to common shareholders, as reported	\$ 2,187,560	\$ (2,102,318 )
Deduct: Total stock-based compensation expense determined under the fair value based method for all awards, net of related tax effects	(853,000 )	(218,000 )
Pro forma net income (loss)	\$ 1,334,560	\$ (2,320,318 )
Basic income (loss) per common share as reported	\$ 0.88	\$ (0.85 )
Basic income (loss) per common share pro forma	\$ 0.54	\$ (0.94 )
Diluted income per common share as reported	\$ 0.80	N/A
Diluted income per common share pro forma	\$ 0.49	N/A

The Bank estimates the fair value of options on the date of grant using a Black-Scholes option pricing model that uses assumptions based on expected option life, expected stock volatility and the risk-free interest rate. The simplified method described in Securities and Exchange Commission Staff Accounting Bulletin No. 107 was used to determine the expected term of the Bank's options in 2006 and 2005. Previously, management had estimated the expected term based upon expected exercise habits. Expected stock volatility is based on the historical volatility of the average volatility of the common stock of selected members of a peer group of financial institutions. The risk-free rate is based on the U.S. Treasury yield curve and the expected term of the options.

The fair value of each option was estimated on the date of grant using the following assumptions:

	2006	2005	2004
Expected volatility	23.65% to 24.19%	23.96% to 24.45%	21.80% to 23.69%
Risk-free interest rate	4.34% to 5.11%	3.92% to 4.41%	3.58 to 4.34
Expected option life	6.5 years	6 to 6.5 years	6.5 years
Dividend yield	N/A	N/A	N/A

**DIABLO VALLEY BANK**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Comprehensive Income (Loss)*

*Comprehensive income (loss) is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income or loss that historically has not been recognized in the calculation of net income or loss. Unrealized gains and losses on the Bank's available-for-sale investment securities are included in other comprehensive income or loss, adjusted for realized gains or losses included in net income or loss. Total comprehensive income (loss) and the components of accumulated other comprehensive income (loss) are presented in the statement of changes in shareholders' equity.*

*Impact of New Financial Accounting Standard*

*Accounting for Uncertainty in Income Taxes*

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. The Bank presently recognizes income tax positions based on management's estimate of whether it is reasonably possible that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. If there are changes in net assets as a result of the application of FIN 48, these will be accounted for as an adjustment to the opening balance of retained earnings. Management will adopt FIN 48 in the first quarter of 2007 and does not expect the adoption to have a material impact on the Bank's financial position or results of operations.

**3. INVESTMENT SECURITIES**

*Available-for-Sale*

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2006 and 2005 consisted of the following:

	<b>2006</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
Debt securities:				
U.S. Government agencies	\$ 2,253,187	\$	\$ (15,436 )	\$ 2,237,751

**DIABLO VALLEY BANK**  
**NOTES TO FINANCIAL STATEMENTS (Continued)**

**3. INVESTMENT SECURITIES (Continued)**