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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2004

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________to _________

Commission file number 000-23877

Heritage Commerce Corp

(Exact name of Registrant as Specified in its Charter)

California	**77-0469558**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

150 Almaden Boulevard
San Jose, California 95113
(Address of Principal Executive Offices including Zip Code)

(408) 947-6900
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days. YES [X] NO [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES [X] NO [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS:

The Registrant had 11,586,779 shares of Common Stock outstanding on May 7, 2004.

Heritage Commerce Corp and Subsidiaries
Quarterly Report on Form 10-Q
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Part I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HERITAGE COMMERCE CORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands)	March 31, 2004	December 31, 2003
ASSETS		
Cash and due from banks	$ 49,684	$ 39,978
Interest bearing deposits in other financial institutions	2,041	2,039
Federal funds sold	67,700	72,200
Total cash and cash equivalents	119,425	114,217
Securities available-for-sale, at fair value	204,705	153,473
Loans held for sale, at lower of cost or market	25,512	30,638
Loans, net of deferred costs	670,739	666,088
Allowance for probable loan losses	(12,151)	(13,451)
Loans, net	658,588	652,637
Premises and equipment, net	3,711	4,034
Accrued interest receivable and other assets	20,673	20,425
Corporate owned life insurance	25,602	25,273
Other investments	2,507	2,504
TOTAL	**$ 1,060,723**	**$ 1,003,201**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits		
Demand, noninterest bearing	$ 287,633	$ 238,423
Demand, interest bearing	108,764	105,260
Savings and money market	340,212	345,886
Time deposits, under $100	39,724	39,869
Time deposits, $100 and over	97,634	94,002
Brokered deposits	11,018	11,970
Total deposits	884,985	835,410
Accrued interest payable and other liabilities	10,057	10,643
Other borrowings	48,600	43,600
Notes payable to subsidiary grantor trusts	23,702	23,702
Total liabilities	967,344	913,355
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized; none outstanding	--	--
Common stock, no par value; 30,000,000 shares authorized; shares outstanding: 11,495,008 at March 31, 2004 and 11,381,037 at December 31, 2003	65,776	65,234
Unallocated ESOP shares	(380)	(443)
Accumulated other comprehensive income, net of taxes	1,000	79
Retained earnings	26,983	24,976
Total shareholders' equity	93,379	89,846
TOTAL	**$ 1,060,723**	**$ 1,003,201**

See notes to condensed consolidated financial statements

HERITAGE COMMERCE CORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED INCOME STATEMENTS (UNAUDITED)

(Dollars in thousands, except per share data)	Three Months Ended March 31, 2004	2003
Interest income:		
Loans, including fees	$ 10,514	$ 11,185
Securities, taxable	1,284	1,069
Securities, non-taxable	115	96
Interest bearing deposits in other financial institutions	3	16
Federal funds sold	68	82
Total interest income	11,984	12,448
Interest expense:		
Deposits	1,581	2,280
Subsidiary grantor trusts	482	490
Other	126	3
Total interest expense	2,189	2,773
Net interest income before provision for probable loan losses	9,795	9,675
Provision for probable loan losses	600	1,300
Net interest income after provision for probable loan losses	9,195	8,375
Noninterest income:		
Gain on sale of loans	727	557
Servicing income	505	425
Service charges and other fees on deposit accounts	473	411
Appreciation of company owned life insurance	329	334
Gain on sale of securities available-for-sale	212	425
Mortgage brokerage fees	119	363
Other	109	449
Total noninterest income	2,474	2,964
Noninterest expenses:		
Salaries and employee benefits	4,720	4,704
Occupancy	1,050	819
Loan origination costs	357	317
Professional fees	355	271
Advertising and promotion	247	171
Furniture and equipment	237	391
Client services	185	250
Telephone	113	83
Stationery & supplies	70	106
Other	1,378	1,388
Total noninterest expenses	8,712	8,500
Income before provision for income taxes	2,957	2,839
Provision for income taxes	950	910
Net income	**$ 2,007**	**$ 1,929**
Earnings per share:		
Basic	$ 0.18	$ 0.17
Diluted	$ 0.17	$ 0.17

See notes to condensed consolidated financial statements

HERITAGE COMMERCE CORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003
Cash flows from operating activities:		
Net income	$ 2,007	$ 1,929
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	472	429
Provision for probable loan losses	600	1,300
Gain on disposals of property and equipment	(10)	--
Gain on sale of securities available-for-sale	(212)	(425)
Amortization /accretion of discounts and premiums on securities	116	350
Gains on sales of loans	(727)	(557)
Proceeds from sales of loans held for sale	13,480	10,855
Originations of loans held for sale	(12,450)	(18,341)
Maturities of loans held for sale	4,823	9,351
Appreciation of Company Owned Life Insurance	(329)	(334)
Effect of changes in:		
Accrued interest receivable and other assets	(227)	956
Accrued interest payable and other liabilities	(1,124)	171
Net cash provided by operating activities	6,419	5,684
Cash flows from investing activities:		
Net (increase) decrease in loans	(6,551)	22,101
Purchases of securities available-for-sale	(70,162)	(4,087)
Maturities/paydowns/calls of securities available-for-sale	2,890	9,098
Proceeds from sales of securities available-for-sale	17,637	21,370
(Purchases) redemption of other investments	(3)	316
Purchases of premises and equipment	(139)	(115)
Net cash (used in) provided by investing activities	(56,328)	48,683
Cash flows from financing activities:		
Net increase (decrease) in deposits	49,575	(17,310)
Net proceeds from issuance of common stock	542	274
Net change in other borrowings	5,000	--
Net cash provided by (use in) financing activities	55,117	(17,036)
Net increase in cash and cash equivalents	5,208	37,331
Cash and cash equivalents, beginning of period	114,217	86,632
Cash and cash equivalents, end of period	**$ 119,425**	**$ 123,963**
Supplemental disclosures of cash paid during the period for:		
Interest	$ 2,547	$ 3,385
Income taxes	$ --	$ 350

See notes to condensed consolidated financial statements

1) Basis of Presentation

The unaudited condensed consolidated financial statements of Heritage Commerce Corp (the "Company") and its wholly owned subsidiary: Heritage Bank of Commerce (HBC) have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain information and notes required by accounting principles generally accepted in the United States of America ("GAAP") for annual financial statements are not included herein. The interim statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2003. The Company has also established the following unconsolidated subsidiary grantor trusts: Heritage Capital Trust I; Heritage Statutory Trust I; Heritage Statutory Trust II; and Heritage Commerce Corp Statutory Trust III which are Delaware Statutory business trusts formed for the exclusive purpose of issuing and selling trust preferred securities.

HBC is a commercial bank serving customers located in Santa Clara, Alameda, and Contra Costa counties of California. No customer accounts for more than 10 percent of revenue for HBC or the Company. Management evaluates the Company's performance as a whole and does not allocate resources based on the performance of different lending or transaction activities. Accordingly, the Company and its subsidiary operate as one business segment.

In the Company's opinion, all adjustments necessary for a fair presentation of these condensed consolidated financial statements have been included and are of a normal and recurring nature. Certain reclassifications have been made to prior year amounts to conform to current year presentation.

The results for the three months ended March 31, 2004 are not necessarily indicative of the results expected for any subsequent period or for the entire year ending December 31, 2004.

2) Stock-Based Compensation

The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. No compensation expense has been recognized in the financial statements for employee stock arrangements, as the Company's stock option plan provides for the issuance of options at a price of no less than the fair market value at the date of the grant.

SFAS No. 123, Accounting for Stock-Based Compensation, requires the disclosure of pro forma net income and earnings per share had the Company adopted the fair value method at the grant date of all stock options. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which differ significantly from the Company's stock option awards. Those models also require subjective assumptions, which greatly affect the calculated values. The Company's calculations were made using the Black-Scholes option pricing model with the following weighted average assumptions: expected life, 84 months; risk-free interest rate, 3.31% and 3.34% for March 31, 2004 and 2003; stock volatility of 37% and 22% in March 31, 2004 and 2003; and no dividends during the expected term. The Company's calculations are based on a multiple option valuation approach, and forfeitures are recognized as they occur.

Had compensation expense for the Company's stock option plan been determined under the requirements of SFAS No. 123 the Company's pro forma net income and earnings per common share would have been as follows:

(Dollars in thousands, except per share data)	Three Months Ended March 31, 2004	2003
Net income		
As reported	$ 2,007	$ 1,929
Less: Compensation expense for amortization of fair value of stock awards, net of taxes	(183)	(176)
Pro forma	$ 1,824	$ 1,753
Net income per common share - basic		
As reported	$ 0.18	$ 0.17
Pro forma	$ 0.16	$ 0.16
Net income per common share - diluted		
As reported	$ 0.17	$ 0.17
Pro forma	$ 0.15	$ 0.15

3) Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average common shares outstanding. Diluted earnings per share reflects potential dilution from outstanding stock options, using the treasury stock method. There were 117,770 and 843,584 stock options at March 31, 2004 and 2003 considered to be antidilutive and excluded from the computation of diluted earnings per share. For each of the periods presented, net income is the same for basic and diluted earnings per share. Reconciliation of weighted average shares used in computing basic and diluted earnings per share is as follows:

	March 31, 2004	2003
Weighted average common shares outstanding - used in computing basic earnings per share	11,375,388	11,135,467
Dilutive effect of stock options outstanding, using the treasury stock method	422,941	261,432
Shares used in computing diluted earnings per share	11,798,329	11,396,899

4) Comprehensive Income

Comprehensive Income includes net income and other comprehensive income, which represents the change in the Company's net assets during the period from non-owner sources. The Company's sources of other comprehensive income are unrealized gains and losses on securities available-for-sale and I/O strips, which are treated like available-for-sale securities, and are presented net of tax. Reclassification adjustments resulting from gains or losses on investment securities that were realized and included in net income of the current period that also had been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose are excluded from comprehensive income of the current period. The Company's total comprehensive income was as follows:

(Dollars in thousands)	Three Months Ended March 31, 2004	2003
Net income	$ 2,007	$ 1,929
Other comprehensive income (loss), net of tax:		
Net unrealized holding gains (losses) on available-for-sal securities and Interest-Only strips during the period	1,065	(63)
Less: reclassification adjustment for realized gains on available-for-sale securities included in net income during the period	(144)	(289)
Other comprehensive income (loss)	921	(352)
Comprehensive income	$ 2,928	$ 1,577

5) Supplemental Retirement Plan

The Company has a supplemental retirement plan covering key executives and directors (Plan). The Plan is a nonqualified defined benefit plan and is unsecured and unfunded and there are no Plan assets. For the current fiscal year ending December 31, 2004, the Company estimates the contributions to be paid to the Plan will be $1,200,000 of which $237,000 was paid in the first quarter of 2004. The following table presents the amount of periodic benefit cost recognized for the quarters ended March 31, 2004 and 2003:

	March 31,	
(Dollars in thousands)	**2004**	**2003**
Components of net periodic benefits cost		
Service cost	$ 182	$ 114
Interest cost	102	50
Amortization of (gain)/loss	40	(6)
Net periodic benefit cost	$ 324	$ 158

6) Commitments and Contingencies

Financial Instruments with Off-Balance Sheet Risk

HBC is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its clients. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk, in excess of the amounts recognized in the balance sheets.

HBC's exposure to credit loss in the event of non-performance of the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. HBC uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Credit risk is the possibility that a loss may occur because a party to a transaction failed to perform according to the terms of the contract. HBC controls the credit risk of these transactions through credit approvals, limits, and monitoring procedures. Management does not anticipate any significant losses as a result of these transactions.

Commitments to extend credit as of March 31, were as follows:

(Dollars in thousands)	**2004**	**2003**
Commitments to extend credit	$ 290,827	$ 282,094
Standby letters of credit	8,542	2,738
	$ 299,369	$ 284,832

Commitments to extend credit are agreements to lend to a client as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since some of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. HBC evaluates each client's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by HBC upon the extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include cash, marketable securities, accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, and/or residential properties. Fair value of these instruments is not considered significant.

Standby letters of credit are written with conditional commitments issued by HBC to guaranty the performance of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to clients. The Company has a deferred liability of $22,000 as of March 31, 2004, which represents the premiums received on the outstanding financial standby letters of credit. The Company recognizes these premiums as income as the commitments are used or as they expire.

7) Reclassifications

Certain amounts in the December 31, 2003 and March 31, 2003 financial statements have been reclassified to conform to the March 31, 2004 financial statements presentation.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Discussions of certain matters in this Report on Form 10-Q may constitute forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and as such, may involve risks and uncertainties. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations, are generally identifiable by the use of words such as "believe", "expect", "intend", "anticipate", "estimate", "project", or similar expressions. These forward-looking statements relate to, among other things, expectations of the business environment in which the Company operates, projections of future performance, potential future performance, potential future credit experience, perceived opportunities in the market, and statements regarding the Company's mission and vision. The Company's actual results, performance, and achievements may differ materially from the results, performance, and achievements expressed or implied in such forward-looking statements due to a wide range of factors. The factors include, but are not limited to changes in interest rates, general economic conditions, legislative and regulatory changes, monetary and fiscal policies of the US Government, real estate valuations, competition in the financial services industry, and other risks. All of the Company's operations and most of its customers are located in California. California economic outlook and could have an effect on the future operations of the Company or its customers, including borrowers. The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

Heritage operates as the bank holding company for its subsidiary bank: Heritage Bank of Commerce (the "Bank"). HBC is California state chartered bank, which offers a full range of commercial and personal banking services to residents and the business/professional community in Santa Clara, Contra Costa and Alameda Counties, California.

CRITICAL ACCOUNTING POLICIES

General

Heritage Commerce Corp's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The financial information contained within our consolidated financial statements is, to a significant extent, based on approximate measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. In certain instances, we use a discount factor and prepayment assumptions to determine the present value of assets and liabilities. A change in the discount factor or prepayment spreads could increase or decrease the values of those assets and liabilities which would result in either a beneficial or adverse impact to our financial results. We use historical loss factors as one factor in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use. We apply Accounting Principles Board (APB) No. 25, "Accounting for Stock Issued to Employees" and related interpretations to account for our stock option plan awards. Other estimates that we use are related to the expected useful lives of our depreciable assets. In addition GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

Allowance for Probable Loan Losses

The allowance for probable loan losses is an estimate of the losses that may be sustained in the Company's loan portfolio. The allowance is based on two basic principles of accounting. (1) Statement of Financial Accounting Standards (SFAS) No. 5 "Accounting for Contingencies", which requires that losses be accrued when they are probable of occurring and estimable and (2) SFAS No. 114, "Accounting by Creditors for Impairment of a Loan", which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The Company's allowance for probable loan losses has three basic components: the formula allowance, the specific allowance and the unallocated allowance. Each of these components is determined based upon estimates that can and do change when the actual events occur. The formula allowance uses an historical loss view as an indicator of future losses and, as a result formula losses could differ from the losses incurred in the future. The specific allowance uses various techniques to arrive at an estimate of loss. Historical loss information, and fair market value of collateral are used to estimate those losses. The use of these values is inherently subjective and our actual losses could differ from the estimates. The unallocated allowance captures losses that are attributable to various economic events, industry or geographic sectors whose impact on the portfolio have occurred but have yet to be recognized in either the formula or specific allowances. For further information regarding our allowance for credit losses, see Allowance for Probable Loan Losses on page 18.

Loan Sales and Servicing

The amounts of gains recorded on sales of loans and the initial recording of servicing assets and interest only strips is based on the estimated fair values of the respective components. In recording the initial value of the servicing assets and the fair value of the Interest-Only (I/O) strips receivable, the Company uses estimates which are made based on management's expectations of future prepayment and discount rates. For the quarter ended March 31, 2004, management's estimate of constant prepayment rate ("CPR") was 14% and the weighted average discount rate assumption was 10%. These prepayment and discount rates were based on current market conditions and historical performance of the various pools of loans. If actual prepayments with respect to sold loans occur more quickly than projected the carrying value of the servicing assets may have to be adjusted through a charge to earnings. A corresponding decrease in the value of the I/O strip receivable would also be expected.

Stock Based Awards

Under APB No. 25, compensation cost for stock options is measured as the excess, if any, of the fair market value of the Company's stock at the date of the grant over the amount required to be paid to the Company by the optionee upon exercising the option. Because the Company's stock option plans provide for the issuance of options at a price of no less than the fair market value at the date of the grant, no compensation expense is required to be recognized for stock options on the date of grant.

RESULTS OF OPERATIONS

Overview

Net income for the three months ended March 31, 2004 was $2,007,000, up 4% from $1,929,000 for the three months ended March 31, 2003. Earnings per diluted share were $0.17 for the three months ended March 31, 2004 and 2003. Annualized return on average assets and return on average equity for the quarter ended March 31, 2004 were 0.82% and 8.83%, compared with returns of 0.85% and 9.32%, for the same period in the prior year.

For the three months ended March 31, 2004, as compared with the same period in the prior year, net interest income increased slightly from $9,675,000 to $9,795,000, an increase of $120,000, or 1%. The Company's net interest margin was 4.38% for the three months ended March 31, 2004, down 26 basis points from 4.64% for the three months ended March 31, 2003, the change reflects the decrease in the yields on earning assets of 61 basis points offset by a corresponding decrease in the cost of interest bearing liabilities of 47 basis points and the effects of the change in mix of earning assets, primarily the increase in the average level of investment securities, and the mix in interest bearing liabilities.

Total assets as of March 31, 2004 were $1,060,723,000, an increase of $117,608,000, or 12%, from $943,115,000 as of March 31, 2003, and an increase of $57,522,000, or 6%, from total assets of $1,003,201,000 as of December 31, 2003. Total deposits as of March 31, 2004 were $884,985,000, an increase of $60,359,000, or 7%, from $824,626,000 as of March 31, 2003, and an increase of $49,575,000, or 6%, from total deposits of $835,410,000 as of December 31, 2003.

Total loan portfolio as of March 31, 2004 were $670,739,000, an increase of $19,213,000, or 3%, from $651,526,000 as of March 31, 2003 and an increase of $4,651,000, or 1%, from $666,088,000 as of December 31, 2003. The Company's allowance for probable loan losses was $12,151,000, or 1.81%, of total loans at March 31, 2004. This compares with an allowance for probable loan losses of $14,247,000, or 2.19%, and $13,451,000, or 2.02% of total loans at March 31, 2003 and December 31, 2003. The decrease in the overall level of the allowance of loan losses since December 31, 2003 is primarily the result of a $2,000,000 charge-off related to one unsecured commercial loan in the first quarter of 2004 offset by the provisions made during the quarter. The Company's nonperforming assets were $4,801,000, compared to $4,800,000 as of March 31, 2003 and $4,580,000 as of December 31, 2003.

The Company's shareholders' equity at March 31, 2004 was $93,379,000, up from $84,143,000 at March 31, 2003 and $89,846,000 as of December 31, 2003. The increase in shareholders' equity is a result of the income generated during the period, the exercise of common stock options and the increase in other comprehensive income from fair value changes. Book value per share increased to $8.12 at March 31, 2004, from $7.50 at March 31, 2003 and $7.89 at December 31, 2003. The Company's leverage capital ratio was 11.54% at March 31, 2004 compared to 11.25% at March 31, 2003 and 11.17% at December 31, 2003.

Net Interest Income and Net Interest Margin

The following table presents the Company's average balance sheet, net interest income and the resultant yields and rates paid for the period presented:

(Dollars in thousands)	For the Three Months Ended March 31, 2004 Average Balance	Interest Income/ Expense	Average Yield/ Rate	For the Three Months Ended March 31, 2003 Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets:						
Loans, gross	$ 691,624	$ 10,514	6.11%	$ 693,852	$ 11,185	6.54%
Investment securities	176,184	1,399	3.19%	116,921	1,165	4.04%
Interest bearing deposits in other financial institutions	2,039	3	0.59%	7,312	16	0.89%
Federal funds sold	29,145	68	0.94%	28,014	82	1.19%
Total interest earning assets	898,992	$ 11,984	5.36%	846,099	$ 12,448	5.97%
Cash and due from banks	45,035			37,211		
Premises and equipment, net	3,983			5,215		
Other assets	31,777			34,431		
Total assets	$ 979,787			$ 922,956		
Liabilities and shareholders' equity:						
Deposits:						
Demand, interest bearing	$ 106,143	$ 119	0.45%	$ 92,657	$ 146	0.64%
Savings and money market	336,364	841	1.01%	302,756	976	1.31%
Time deposits, under $100	39,611	142	1.44%	45,165	243	2.18%
Time deposits, $100 and over	96,251	349	1.46%	107,853	550	2.07%
Brokered deposits	11,652	130	4.49%	37,947	365	3.90%
Other borrowings	52,191	608	4.69%	24,022	493	8.32%
Total interest bearing liabilities	642,212	$ 2,189	1.37%	610,400	$ 2,773	1.84%
Demand, noninterest bearing	234,693			217,630		
Other liabilities	11,502			10,978		
Total liabilities	888,407			839,008		
Shareholders' equity	91,380			83,948		
Total liabilities and shareholders' equity	$ 979,787			$ 922,956		
Net interest income / margin		$ 9,795	4.38%		$ 9,675	4.64%

Note: Yields and amounts earned on loans include loan fees of $991,000 and $1,101,000 for the three month periods ended March 31, 2004 and 2003, respectively. Interest income is reflected on an actual basis, not a fully taxable equivalent basis, and does not include a fair value adjustment. Nonaccrual loans of $4,171,000 and $4,800,000 for the period ended March 31, 2004 and 2003, respectively, are included in the average balance calculation above.

The Company's net interest income for the three months ended March 31, 2004 was $9,795,000, an increase of $120,000, or 1%, over the same three month period in the prior year. For the three months ended March 31, 2004 compared to the same periods in the prior year, average interest earning assets increased by $52,893,000, or 6%. For the three months ended March 31, 2004, the average yield on interest earning assets was 5.36%, down 61 basis points from 5.97% for the same period in 2003. Over the same period the rates paid on interest bearing liabilities declined 47 basis points to 1.37% from 1.84%. As a result, the net interest margin decreased 26 basis points to 4.38% for the three months ended March 31, 2004, from 4.64% for the same period in the prior year. The decrease in the first quarter of 2004 compared to the same period in the prior year was primarily attributable to the continuing low interest rate environment and changes in the level and mix of earning assets and interest bearing liabilities. Overall, the changes in volume contributed $373,000 to net interest income while the effect of the changes in rates reduced this contribution by $253,000 resulting in the overall increase in March 31, 2004 from March 31, 2003 of $120,000.

The following table sets forth an analysis of the changes in interest income resulting from changes in the average volume of interest earning assets and liabilities and changes in the average rates earned and paid. The total change is shown in the column designated "Net Change" and is allocated in the columns to the left, to the portions respectively attributable to volume changes and rate changes that occurred during the period indicated. Changes due to both volume and rate have been allocated to the change in volume.

	Three Months Ended March 31, 2004 vs. 2003		
	Increase (Decrease) Due to Change In:		
(Dollars in thousands)	**Average Volume**	**Average Rate**	**Net Change**
Interest earning assets			
Loans, gross	$ (27)	$ (644)	$ (671)
Investments securities	472	(238)	234
Interest bearing deposits in other financial institutions	(8)	(5)	(13)
Federal funds sold	3	(17)	(14)
Total interest earning assets	$ 440	$ (904)	$ (464)
Interest bearing liabilities			
Demand, interest bearing	15	(42)	(27)
Savings and money market	81	(216)	(135)
Time deposits, under $100	(20)	(81)	(101)
Time deposits, $100 and over	(43)	(158)	(201)
Brokered deposits	(294)	59	(235)
Other borrowings	328	(213)	115
Total interest bearing liabilities	$ 67	$ (651)	$ (584)
Net interest income	$ 373	$ (253)	$ 120

Provision for Probable Loan Losses

The provision for probable loan losses represents the current period expense associated with maintaining an appropriate allowance for credit losses. The loan loss provision and level of allowance for each period is dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of the quality of the loan portfolio, the valuation of problem loans and the general economic conditions in the Company's market area. Periodic fluctuations in the provision for loan losses result from management's assessment of the adequacy of the allowance for probable loan losses; however, actual loan losses may vary from current estimates. For the three months ended March 31, 2004, the provision for probable loan losses was $600,000, compared to $1,300,000 for the same periods in the prior year. See additional discussion at Allowance for Probable Loan Losses.

Noninterest Income

The following table sets forth the various components of the Company's noninterest income for the periods indicated:

	Three Months Ended March 31,		Increase (decrease) 2004 versus 2003	
(Dollars in thousands)	2004	2003	Amount	Percent
Gain on sale of loans	$ 727	$ 557	$ 170	31 %
Servicing income	505	425	80	19 %
Service charges and other fees on deposits accounts	473	411	62	15 %
Appreciation of company owned life insurance	329	334	(5)	(1)%
Gain on sale of securities available-for-sale	212	425	(213)	(50)%
Mortgage brokerage fees	119	363	(244)	(67)%
Other	109	449	(340)	(76)%
Total	$ 2,474	$ 2,964	$ (490)	(17)%

Noninterest income for the three months ended March 31, 2004 was $2,474,000, down 17% from $2,964,000 for the same period in the prior year. The decrease was primarily due to the amendment of an equipment lease agreement resulting in a change in the classification from equipment under operating leases to a direct financing lease arrangement, which is now included in the loan portfolio. As a result, the payment amounts are now recorded as principal and interest payments rather than noninterest income and expenses. The decrease in gain on sale of securities available-for-sale of $213,000 and mortgage brokerage fees of $244,000, which resulted from the change in the underlying market conditions, for the first quarter of 2004 from the prior year was partially offset by an increase in gains on sales of loans of $170,000 and servicing income of $80,000, which was primarily the result of expansion of the SBA lending operation into additional geographic areas of California and the overall increase in the level of loans serviced. The increases in service charges and other fees on deposit accounts of $62,000 was due to an increase in the activity and level of demand deposit accounts.

Noninterest Expense

The following table sets forth the various components of the Company's noninterest expenses for the periods indicated:

	Three Months Ended March 31,		Increase (decrease) 2004 versus 2003	
(Dollars in thousands)	2004	2003	Amount	Percent
Salaries and employee benefits	$ 4,720	$ 4,704	$ 16	0 %
Occupancy	1,050	819	231	28 %
Loan origination costs	357	317	40	13 %
Professional fees	355	271	84	31 %
Advertising and promotion	247	171	76	44 %
Furniture and equipment	237	391	(154)	(39)%
Client services	185	250	(65)	(26)%
Telephone	113	83	30	36 %
Stationery & supplies	70	106	(36)	(34)%
Other	1,378	1,388	(10)	(1)%
Total	$ 8,712	$ 8,500	$ 212	2 %

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

	For The Three Months Ended March 31,			
(Dollars in thousands)	2004	Percent of Total	2003	Percent of Total
Salaries and employee benefits	$ 4,720	54 %	$ 4,704	55 %
Occupancy	1,050	12 %	819	10 %
Loan origination costs	357	4 %	317	4 %
Professional fees	355	4 %	271	3 %
Advertising and promotion	247	3 %	171	2 %
Furniture and equipment	237	3 %	391	5 %
Client services	185	2 %	250	3 %
Telephone	113	1 %	83	1 %
Stationery & supplies	70	1 %	106	1 %
Other	1,378	16 %	1,388	16 %
Total	$ 8,712	100 %	$ 8,500	100 %

Noninterest expenses for the three months ended March 31, 2004 were $8,712,000, up $212,000, or 2%, from $8,500,000 for the same period in the prior year.

For the three month period ended March 31, 2004 compared to the three month period ended March 31, 2003:

- Salaries and benefits increased $16,000, or less than 1%, to $4,720,000, as compared to the same period in the prior year. Salaries and benefits are expected to increase in the second quarter of 2004 by approximately $1,100,000 for severance payments to be paid as a result of the resignation of the chief executive officer effective May 5, 2004. See Part II Item 4 and Exhibit 4.1 for additional information.

- Occupancy increased by $231,000, or 28%, primarily as a result of increased rental costs, depreciation on leasehold improvements and write-offs associated with the outsourcing of the data processing function. Occupancy costs, as a percentage of total noninterest expenses increased to 12% from 10% over the comparative three month periods.

- Loan origination costs increased by $40,000, or 13%, to $357,000. The increase from 2003 was primarily due to continued growth in the loan portfolio. Loan origination cost, as a percentage of total noninterest expenses remained fairly constant over the comparative three month periods.

- Professional fees increased $84,000, or 31%, to $355,000. The increases were primarily due to increased legal expenses. Professional fees, as a percentage of total noninterest expenses increased to 4% from 3% over the comparative three month periods.

- Advertising and promotion increased $76,000, or 44%, to $247,000. The increase from 2003 was primarily as a result of several new promotions and sponsorships in 2004. Advertising and promotion, as a percentage of toal noninterest expenses increase to 3% from 2% over the comparative three month periods.

- Furniture and equipment decreased by $154,000, or 39%, to $237,000, due to the decrease in the level of purchase of small equipment, fewer equipment repairs, and lower depreciation on furniture and equipment in 2004. Furniture and equipment, as a percentage of total noninterest expenses decrease to 3% from 5% over the comparative three month periods.

- Client services decreased $65,000, or 26%, to $185,000, due to the decrease in services fees charged to the Company from the third party vendors in 2004. Client services, as a percentage of total noninterest expenses decreased to 2% from 3% over the comparative three month periods.

- Telephone expense increased by $30,000, or 36%, to $113,000. Telephone expense, as a percentage of total noninterest expenses remained fairly constant over the comparative three month periods.

- Stationery and supplies decreased by $36,000, or 34%, to $70,000. Stationery and supplies, as a percentage of total noninterest expenses also remained fairly constant over the comparative three month periods.

- Other noninterest expense decreased slightly by $10,000, or 1%, to $1,378,000.

Income Taxes

The provision for income taxes for the three months ended March 31, 2004 was $950,000, as compared to $910,000 for the same periods in the prior year. The following table shows the income tax rate for each period indicated.

	Three Months Ended March 31,	
	2004	**2003**
Income tax rate	32.13 %	32.05 %

The difference in the effective tax rate compared to the statutory tax rate of 42% is primarily the result of the Company's investment in Bank Owned Life Insurance policies whose earnings are not subject to taxes, low income housing tax credits and investments in municipal securities.

FINANCIAL CONDITION

Total assets increased $57,522,000, or 6%, to $1,060,723,000 at March 31, 2004 from $1,003,201,000 at December 31, 2003, and increased $117,608,000, or 12%, from $943,115,000 at March 31, 2003. Securities available-for-sale increased $51,232,000, or 33%, to $204,705,000 at March 31, 2004 from $153,473,000 at December 31, 2003, and increased $105,269,000, or 106%, from $99,436,000 at March 31, 2003. Total loan portfolio increased $4,651,000, or 1%, to $670,739,000 at March 31, 2004 from $666,088,000 at December 31, 2003, and increased $19,213,000, or 3%, from $651,526,000 at March 31, 2003. The increase in the assets was primarily funded by increases in deposits and other borrowings. Total deposits increased $49,575,000 or 6% to $884,985,000 at March 31, 2004 from $835,410,000 at December 31, 2003, and increased $60,359,000, or 7%, from $824,626,000 at March 31, 2003. Other borrowings increased $5,000,000, or 11%, to $48,600,000 at March 31, 2004 from $43,600,000 at December 31, 2003. The Company did not have any other borrowings at March 31, 2003.

Securities Portfolio

The following table sets forth the estimated fair value of investment securities at the dates indicated:

	March 31,		December 31,
(Dollars in thousands)	**2004**	**2003**	**2003**
Securities available-for-sale (at fair value):			
U.S. Treasury	$ 6,021	$ 4,631	$ 7,015
U.S. Government Agencies	63,301	33,434	36,115
Mortgage-Backed Securities	105,377	40,335	79,615
Municipals	14,835	9,115	15,704
CMOs	15,171	11,921	15,024
Total securities available-for-sale	$ 204,705	$ 99,436	$ 153,473

The following table summarizes the composition of the Company's investment securities and the weighted average yields at March 31, 2004:

	March 31, 2004 Maturity									
	Within One Year		After One and Within Five Years		After Five and Within Ten Years		After Ten Years		Total	
(Dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Securities available-for-sale:										
U.S. Treasury............................	$ --	-- %	$ 6,021	1.67 %	$ --	-- %	$ --	-- %	$ 6,021	1.67 %
U.S. Government Agencies..........	--	-- %	63,301	2.17 %	--	-- %	--	-- %	63,301	2.17 %
Mortgage-Backed Securities........	--	-- %	331	5.08 %	7,980	3.54 %	97,066	4.09 %	105,377	4.05 %
Municipals - Nontaxable............	472	4.91 %	11,998	2.93 %	2,365	3.29 %	--	-- %	14,835	3.05 %
CMOs...	--	-- %	--	-- %	--	-- %	15,171	3.08 %	15,171	3.08 %
Total available-for-sale..............	$ 472	4.91 %	$ 81,651	2.26 %	$ 10,345	3.48 %	$ 112,237	3.95 %	$ 204,705	3.25 %

Note: Yield on non-taxable municipal securities are not presented on a fully tax equivalent basis.

Loans

Total loan portfolio increased $4,651,000, or 1%, to $670,739,000 at March 31, 2004 from $666,088,000 at December 31, 2003, and increased $19,213,000, or 3%, from $651,526,000 at March 31, 2003.

For the three months ended March 31, 2004, $12,450,000 in loans guaranteed by the U.S. Small Business Administration (SBA) were generated and held for sale, and $12,753,000 of SBA loans held for sale was sold into the secondary market.

At March 31, 2004 and December 31, 2003, the Company serviced SBA loans, which it had sold into the secondary market of approximately $125,117,000 and $117,770,000. At March 31, 2004 and December 31, 2003, the carrying amount of the servicing assets was $1,967,000 and $1,876,000, respectively. There was no valuation allowance as of March 31, 2004 or December 31, 2003. The balance of Interest-Only (I/O) strip receivable at March 31, 2004 and December 31, 2003 was $2,960,000, net of unrealized gain of $945,000, and $2,803,000, net of unrealized gain of $925,000, respectively. These assets represent the servicing spread generated from the sold guaranteed portions of SBA loans. Servicing income from these loans was $505,000 for the quarter ended March 31, 2004, compared to $425,000 for the same period in 2003. Amortization of the related assets was $380,000 for the quarter ended March 31, 2004, compared to $297,000 for the same period in 2003. Heritage Bank of Commerce is a preferred lender with the U.S. Small Business Administration, which allows the Company to grant certain U.S. Small Business Administration loans without the prior approval of the SBA.

The following table summarizes the composition of the Company's loan portfolio at the dates indicated:

	March 31,		December 31,	
(Dollars in thousands)	2004	Total	2003	Total
Commercial..	$ 275,536	41 %	$ 281,561	42 %
Real estate - mortgage................................	287,833	43 %	276,908	42 %
Real estate - land and construction..........	101,389	15 %	101,082	15 %
Direct financing lease.................................	3,749	1 %	3,931	1 %
Consumer...	1,715	0 %	1,743	0 %
Total loans...	670,222	100 %	665,225	100 %
Deferred loan costs....................................	517		863	
Allowance for loan losses..........................	(12,151)		(13,451)	
Loans, net..	$ 658,588		$ 652,637	

The loan portfolio is primarily composed of commercial loans to companies principally engaged in manufacturing, wholesale, and service businesses and real estate lending, with the balance in direct equipment finance leases and consumer loans. While no specific industry concentration is considered significant, the Company's lending operations are dependent on the technology and real estate industries and their supporting companies. The Company's borrowers could be adversely impacted by a downturn in these sectors of the economy, which could reduce the demand for loans and adversely impact the borrowers' abilities to repay their loans.

The following table sets forth the maturity distribution of the Company’s loan portfolio at March 31, 2004:

(Dollars in thousands)	Due in One Year or Less	Over One Year But Less Than Five Years	Over Five Years	Total
Commercial	$ 262,182	$ 12,610	$ 744	$ 275,536
Real estate - mortgage	199,890	48,526	39,417	287,833
Real estate - land and construction	101,389	--	--	101,389
Direct financing lease	982	2,767	--	3,749
Consumer	1,470	245	--	1,715
Total loans	$ 565,913	$ 64,148	$ 40,161	$ 670,222
Loans with variable interest rates	$ 549,996	$ 30,829	$ --	$ 580,825
Loans with fixed interest rates	15,917	33,319	40,161	89,397
Total loans	$ 565,913	$ 64,148	$ 40,161	$ 670,222

The table above also shows the distribution of such loans between those loans with predetermined (fixed) interest rates and those with variable (floating) interest rates. Floating rates generally fluctuate with changes in the prime rate as reflected in the western edition of *The Wall Street Journal*. At March 31, 2004, approximately 87% of the Company’s loan portfolio consisted of floating interest rate loans.

Nonperforming assets

Nonperforming assets consist of nonaccrual loans, loans past due 90 days and still accruing, troubled debt restructurings and other real estate owned. Management generally places loans on nonaccrual status when they become 90 days past due, unless they are well secured and in the process of collection. When a loan is placed on nonaccrual status, any interest previously accrued but not collected is generally reversed from income. Loans are charged off when management determines that collection has become unlikely. Restructured loans are those where the Company has granted a concession on the interest paid or original repayment terms due to financial difficulties of the borrower. Other real estate owned (“OREO”) consists of real property acquired through foreclosure on the related underlying defaulted loans. The following table shows nonperforming assets at the dates indicated:

	March 31,		December 31,
(Dollars in thousands)	2004	2003	2003
Nonaccrual loans	$ 4,171	$ 4,800	$ 3,972
Loans 90 days past due and still accruing	630	--	608
Restructured loans	--	--	--
Total nonperforming loans	4,801	4,800	4,580
Other real estate owned	--	--	--
Total nonperforming assets	$ 4,801	$ 4,800	$ 4,580
Nonperforming assets as a percentage of period end loans plus other real estate owned	0.72 %	0.74 %	0.69 %

As of March 31, 2004, the Company had $4,171,000 loans on nonaccrual status, compared to $3,972,000 as of December 31, 2003, which were considered impaired loans. The impaired loans had a related valuation allowance of $1,287,000 and $464,000 at March 31, 2004 and December 31, 2003, respectively. The Company had $630,000 and $608,000 loans past due 90 days or more and still accruing interest, no restructured loans and no foreclosed assets as of March 31, 2004 and December 31, 2003.

The Company had $4,800,000 in loans on nonaccrual status as of March 31, 2003, which were considered impaired loans. The impaired loans had a related valuation allowance of $634,000 at March 31, 2003. The Company had no loans past due 90 days or more and still accruing interest, no restructured loans and no foreclosed assets as of March 31, 2003.

The Company had $258,000 and $106,000 in foregone interest income on nonaccrual loans for the three months ended March 31, 2004 and 2003, respectively. The Company had $17,000 and zero in interest income for cash payments received on nonaccrual loans for the three months ended March 31, 2004 and 2003, respectively.

The Company assigns a risk grade consistent with the system recommended by regulatory agencies to all of its loans. Grades range from "Pass" to "Loss" depending on credit quality, with "Pass" representing loans that involve an acceptable degree of risk. Management conducts a critical evaluation of the loan portfolio monthly. This evaluation includes periodic loan by loan review for certain loans to evaluate the level of impairment as well as detailed reviews of other loans (either individually or in pools) based on an assessment of the following factors: past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, collateral value, loan volumes and concentrations, size and complexity of the loans, recent loss experience in particular segments of the portfolio, bank regulatory examination results, and current economic conditions in the Company's marketplace, in particular the state of the technology industry and the real estate market.

This process attempts to assess the risk of loss inherent in the portfolio by segregating loans into four components for purposes of determining an appropriate level of the allowance: "watch," "special mention," "substandard" and "doubtful." Additionally, the Company maintains a program for regularly scheduled reviews of certain new and renewed loans by an outside loan review consultant. Any loans identified during an external review process that expose the Company to increased risk are appropriately downgraded and an increase in the allowance for loan losses is established for such loans. Further, the Company is examined periodically by the FDIC, FRB, and the California Department of Financial Institutions at which time a further review of loan quality is conducted.

Loans that demonstrate a weakness, for which there is a possibility of loss if the weakness is not corrected, are categorized as "classified." Classified loans include all loans graded substandard, doubtful and loss and may result from problems specific to a borrower's business or from economic downturns that affect the borrower's ability to repay or that cause a decline in the value of the underlying collateral (particularly real estate).

Allowance for Loan Losses

It is the policy of management to maintain the allowance for probable loan losses at a level adequate for risks inherent in the loan portfolio. Based on information currently available to analyze loan loss delinquency and a history of actual charge-offs, management believes that the loan loss allowance is adequate. However, the loan portfolio can be adversely affected if California economic conditions and the real estate market in the Company's market area were to continue to weaken. Additionally, any weakness of a prolonged nature in the technology industry would have a negative impact on the local market. The effect of such events, although uncertain at this time, could result in an increase in the level of nonperforming loans and increased loan losses, which could adversely affect the Company's future growth and profitability. No assurance of the ultimate level of credit losses can be given with any certainty. Loans are charged against the allowance when management believes that the collectibility of the principal is unlikely.

The following table summarizes the Company’s loan loss experience as well as provisions, charge-offs and recoveries to the allowance for loan losses and certain pertinent ratios for the periods indicated:

(Dollars in thousands)	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003	For the Year Ended December 31, 2003
Balance, beginning of period / year	$ 13,451	$ 13,227	$ 13,227
Net charge-offs	(1,900)	(280)	(2,676)
Provision for probable loan losses	600	1,300	2,900
Balance, end of period / year	$ 12,151	$ 14,247	$ 13,451
Ratios:			
Net charge-offs to average loans outstanding	1.16 %	0.17 %	0.41 %
Allowance for loan losses to average loans	1.84 %	2.15 %	2.07 %
Allowance for loan losses to total loans	1.81 %	2.19 %	2.02 %
Allowance for loan losses to nonperforming assets	253 %	297 %	294 %

Charge-offs reflect the realization of losses in the portfolio that were recognized previously though provisions for probable loan losses. The net charge-offs as of March 31, 2004 were $1,900,000, compared to $280,000 as of March 31, 2003. Historical net charge-offs are not necessarily indicative of the amount of net charge-offs that the Company will realize in the future.

The following table summarizes the allocation of the allowance for loan losses (ALL) by loan type and the allocated allowance as a percent of loans outstanding in each loan category at the dates indicated:

	March 31, 2004		March 31, 2003		December 31, 2003	
(Dollars in thousands)	Amount	Percent of ALL by category to total loans by category	Amount	Percent of ALL by category to total loans by category	Amount	Percent of ALL by category to total loans by category
Commercial	$ 9,013	3.27 %	$ 7,910	3.09 %	$ 9,628	3.42 %
Real estate - mortgage	1,803	0.63 %	3,157	1.26 %	2,003	0.72 %
Real estate - land and construction	1,199	1.18 %	3,180	2.25 %	1,714	1.70 %
Direct financing lease	37	0.99 %	--	-- %	39	0.99 %
Consumer	38	2.22 %	51	1.81 %	37	2.12 %
Unallocated	61	-- %	(51)	-- %	30	-- %
Total	$ 12,151	1.81 %	$ 14,247	2.19 %	$ 13,451	2.02 %

The decrease in the overall level of the allowance and in the allowance as a percentage of total loans since December 31, 2003 is primarily the result of the activity related to one unsecured commercial loan. As reported in the Form 10-K for the fiscal year ended December 31, 2003, during the first quarter of 2004 the Company identified a $4 million unsecured commercial line of credit with risks that created doubt about full repayment under the original terms of the agreement. The loan was placed on nonaccrual and a specific reserve was established. Subsequent to placement on nonaccrual, the Company was advised that the borrower had filed for bankruptcy protection. Although the Company continues to negotiate with the borrower within the framework of the bankruptcy, $2.0 million was charged-off in the first quarter of 2004, and a specific reserve of $1.0 million was established for the remaining balance of $2.0 million. Other than the loans already classified, the Company has not identified any additional potential problem loans at March 31, 2004.

Loans are charged against the allowance when management believes that the collectibility of the principal is doubtful. The Company's methodology for assessing the appropriateness of the allowance consists of several key elements, which include specific allowances, the formula allowance and the unallocated allowance.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a credit that management believes indicate the probability that a loss may be incurred in excess of the amount determined by the application of the formula allowance. As of March 31, 2004, nonperforming loans had a related specific valuation allowance of $1,335,000 compared to a specific valuation allowance of $474,000 at December 31, 2003.

The formula allowance is calculated by applying loss factors to outstanding loans and certain unused commitments. Loss factors are based on management's experience and may be adjusted for significant factors that, in management's judgment, may affect the collectibility of the portfolio as of the evaluation date. Due to the Company's limited historical loss experience, management utilizes their prior industry experience to determine the loss factor for each category of loan. The formula allowance on March 31, 2004 was $10,755,000, compared to $12,947,000 on December 31, 2003. The decrease was primarily attributable to the charge-off related to one commercial unsecured loan and the specific reserve established for that loan.

The unallocated allowance is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. As of March 31, 2004, the Company's unallocated allowance was $61,000, compared to $30,000 on December 31, 2003. In evaluating the appropriateness of the unallocated allowance, management considered the changes in the trend of the volume and severity of past due and classified loans; and trends in the volume of nonaccrual loans, troubled debt restructurings and other loan modifications, changes in national and local economic and business conditions, trends, and developments, including the condition of various market segments, changes in underwriting standards and collection, charge-off, and recovery practices, and changes in the volume and mix of the loan portfolio and in credit concentrations particularly in commercial and real estate land and construction lending. There can be no assurance that the adverse impact of any of these conditions on the Company will not be in excess of the range set forth above.

In addition, the current business, economic, and real estate markets along with the seasoning of the portfolio and the nature and duration of the current business cycle will affect the amount of unallocated reserve.

In an effort to improve its analysis of risk factors associated with its loan portfolio, the Company continues to monitor and to make appropriate changes to its internal loan policies. These efforts better enable the Company to assess risk factors prior to granting new loans and to assess the sufficiency of the allowance for loan losses.

Management believes that it has adequately provided an allowance for estimated probable losses in the credit portfolio. Significant deterioration in Northern California real property values or economic downturns could impact future operating results, liquidity or capital resources and require additional provisions to the allowance or cause losses in excess of the allowance.

Deposits

Total deposits were $884,985,000 at March 31, 2004, up 6%, compared to deposits of $835,410,000 at December 31, 2003, and up 7% from $824,626,000 at March 31, 2003. Compared to December 31, 2003, noninterest bearing demand deposits increased $49,210,000, or 21%, primarily due to a short term $30,328,000, or 51%, increase in title and escrow deposits at March 31, 2004; interest bearing demand deposits increased $3,504,000, or 3%; savings and money market deposits decreased $5,674,000, or 2%; time deposits increased $3,487,000, or 3%; and brokered deposits decreased $952,000, or 8%.

The following table summarizes the distribution of average deposits and the average rates paid for the periods indicated:

	Three Months Ended March 31, 2004		Year Ended December 31, 2003	
(Dollars in thousands)	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
Demand, noninterest bearing	$ 234,693	-- %	$ 238,467	-- %
Demand, interest bearing	106,143	0.45 %	96,772	0.51 %
Saving and money market	336,364	1.01 %	318,774	1.16 %
Time deposits, under $100	39,611	1.44 %	43,060	1.85 %
Time deposits, $100 and over	96,251	1.46 %	101,406	1.79 %
Brokered deposits	11,652	4.49 %	24,559	4.05 %
Total average deposits	$ 824,714	0.77 %	$ 823,038	0.95 %

Deposit Concentration and Deposit Volatility

The following table indicates the maturity schedule of the Company's time deposits of $100,000 or more as of March 31, 2004.

(Dollars in thousands)	Balance	% of Total
Three months or less	$ 48,229	44 %
Over three months through twelve months	50,040	46 %
Over twelve months	10,383	10 %
Total	$ 108,652	100 %

The Company focuses primarily on servicing business accounts that are frequently over $100,000 in average size. Certain types of accounts that the Company makes available are typically in excess of $100,000 in average balance per account, and certain types of business clients whom the Company serves typically carry deposits in excess of $100,000 on average. The account activity for some account types and client types necessitates appropriate liquidity management practices by the Company to ensure its ability to fund deposit withdrawals.

Return on Equity and Assets

The following table indicates the ratios on the annualized return on average assets and average equity and average equity to average assets for each indicated period.

	Three Months Ended March 31,	
	2004	2003
Return on average assets	0.82 %	0.85 %
Return on average equity	8.83 %	9.32 %
Average equity to average assets ratio	9.33 %	9.10 %

Annualized return on average assets and return on average equity for the quarter ended March 31, 2004 were 0.82% and 8.83%, respectively, compared with returns of 0.85% and 9.32%, respectively, for the same period in 2003. The equity to asset ratio for the quarter ended March 31, 2003 was 9.33%, compared to 9.10% for the same period in 2003.

Interest Rate Risk

The planning of asset and liability maturities is an integral part of the management of an institution's net yield. To the extent maturities of assets and liabilities do not match in a changing interest rate environment, net yields may change over time. Even with perfectly matched repricing of assets and liabilities, risks remain in the form of prepayment of loans or investments or in the form of delays in the adjustment of rates of interest applying to either earning assets with floating rates or to interest bearing liabilities. The Company has generally been able to control its exposure to changing interest rates by maintaining primarily floating interest rate loans and a majority of its time certificates with relatively short maturities

The following table sets forth the interest rate sensitivity of the Company's interest-earning assets and interest-bearing liabilities at March 31, 2004, using the rate sensitivity gap ratio. For purposes of the following table, an asset or liability is considered rate-sensitive within a specified period when it can be repriced or when it is scheduled to mature within the specified time frame:

(Dollars in thousands)	Within Three Months	Due in Three to Twelve Months	Due After One to Five Years	Due After Five Years	Not Rate-Sensitive	Total
Interest earning assets:						
Federal funds sold	$ 67,700	$ --	$ --	$ --	$ --	$ 67,700
Interest bearing deposits in other financial Institutions	2,041	--	--	--	--	2,041
Securities	327	145	81,651	122,582	--	204,705
Total loans	525,456	66,486	64,148	40,161	--	696,251
Total interest earning assets	595,524	66,631	145,799	162,743	--	970,697
Cash and due from banks	--	--	--	--	49,684	49,684
Other assets	--	25,602	--	--	14,740	40,342
Total assets	$ 595,524	$ 92,233	$ 145,799	$ 162,743	$ 64,424	$ 1,060,723
Interest bearing liabilities:						
Demand, interest bearing	$ 108,764	$ --	$ --	$ --	$ --	$ 108,764
Savings and money market	340,212	--	--	--	--	340,212
Time deposits	64,103	69,438	14,835	--	--	148,376
Other borrowings	8,800	--	39,800	--	--	48,600
Notes payable to subsidiary grantor trusts	9,279	--	--	14,423	--	23,702
Total interest bearing liabilities	531,158	69,438	54,635	14,423	--	669,654
Noninterest demand deposits	89,807	--	--	--	197,826	287,633
Accrual interest payable and other liabilities	--	--	--	--	10,057	10,057
Shareholders' equity	--	--	--	--	93,379	93,379
Total liabilities and shareholders' equity	$ 620,965	$ 69,438	$ 54,635	$ 14,423	$ 301,262	$ 1,060,723
Interest rate sensitivity GAP	$ (25,441)	$ 22,795	$ 91,164	$ 148,320	$ (236,838)	$ --
Cumulative interest rate sensitivity GAP	$ (25,441)	$ (2,646)	$ 88,518	$ 236,838	$ --	$ --
Cumulative interest rate sensitivity GAP ratio	(2.40)%	(0.25)%	8.35 %	22.33 %	-- %	-- %

Interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities, which may have a significant effect on the net interest margin and are not reflected in the interest sensitivity analysis table. Because of these factors, an interest sensitivity gap report may not provide a complete assessment of the exposure to changes in interest rates. To supplement traditional GAP analysis, the Company performs simulation modeling to estimate the potential effects of changing interest rate environments. The process allows the Company to explore the complex relationships within the GAP over time and various interest rate environments.

Liquidity risk represents the potential for loss as a result of limitations on the Company's ability to adjust for future cash flows, to meet the needs of depositors and borrowers, and to fund operations on a timely and cost-effective basis. The liquidity policy approved by the board of directors requires annual review of the Company's liquidity by the asset/liability committee, which is composed of senior executives, and the finance and investment committee of the board of directors.

The Company's internal asset/liability committee and the finance and investment committee of the board of directors each meet monthly to monitor the Company's investments, liquidity needs and to oversee its asset/liability management. The Company evaluates the rates offered on its deposit products on a weekly basis.

Liquidity and Liability Management

To meet liquidity needs, the Company maintains a portion of its funds in cash deposits in other banks, in Federal funds sold, and in investment securities. At March 31, 2004, the Company's primary liquidity ratio was 20.75%, comprised of $82,123,000 in investment securities available-for-sale with maturities (or probable calls) of up to five years, less $19,993,000 of securities that were pledged to secure public and certain other deposits as required by law and contract; Federal funds sold of $67,700,000, and $49,684,000 in cash and due from banks, as a percentage of total unsecured deposits of $864,992,000.

Capital Resources

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

	March 31,		December 31,	
(Dollars in thousands)	**2004**	**2003**	**2003**	
Capital components:				
Tier 1 Capital	$ 113,412	$ 104,166	$ 110,891	
Tier 2 Capital	10,725	10,117	10,403	
Total risk-based capital	$ 124,137	$ 114,283	$ 121,294	
Risk-weighted assets	$ 857,965	$ 803,951	$ 830,537	
Average assets	$ 982,777	$ 925,821	$ 992,608	
				Minimum Regulatory Requirements
Capital ratios:				
Total risk-based capital	14.5 %	14.2 %	14.6 %	8.0 %
Tier 1 risk-based capital	13.2 %	13.0 %	13.4 %	4.0 %
Leverage ratio (1)	11.5 %	11.3 %	11.2 %	4.0 %

(1) Tier 1 capital divided by average assets (excluding goodwill).

At March 31, 2004 and 2003, and December 31, 2003, the Company's capital met all minimum regulatory requirements. As of March 31, 2004, management believes that HBC was considered "Well Capitalized" under the Prompt Corrective Action Provisions.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

No material changes have occurred during the quarter to the Company's market risk profile or information. For further information refer to the Company's Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

(a) We carried out an evaluation under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as of the end of the period covered by this report, pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934. Based on their review of our disclosure controls and procedures, the principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us that is required to be included in our periodic SEC filings.

(b) There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, such controls.

Part II — OTHER INFORMATION

ITEM 4. - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On May 4, 2004, the Company announced that Brad L. Smith had tendered his resignation as Chief Executive Officer and Director to facilitate the settlement with shareholders who had nominated alternative directors for the upcoming annual meeting. Chairman of the Board William Del Biaggio, Jr. was appointed interim CEO effective immediately, while a search for permanent CEO is completed. The Board appointed Ranson Webster to fill the seat vacated by Smith. Webster is the Company's largest individual shareholder and is one of the founders of HBC. As part of the proposed settlement agreement, the Concerned Shareholders Committee has agreed in principle not to further pursue proxy solicitation measures for two years. The settlement and standstill agreement and the Company's press release of May 5, 2004 announcing execution of the definitive agreement are attached to this report as Exhibits 4.1 and 4.2, respectively, and incorporated herein by reference.

ITEM 6. – EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits included with this filing:

The exhibit list required by this item is incorporated by reference to the Exhibit Index filed as part of this report.

(b) Reports on Form 8-K

The Registrant filed a Current Report on Form 8-K dated March 18, 2004 under item 5 to report Phillip Boyce resigned as a Direct of Heritage Commerce Corp and Heritage Bank of Commerce.

The Registrant furnished a Current Report on Form 8-K dated January 20, 2004 under Item 7 and 12, to report its year end 2003 financial results, containing condensed summarized statements of financial position and results of operations.

The Registrant furnished a Current Report on Form 8-K dated April 23, 2004 under item 7 and item 12 to report its quarter ended March 31, 2004 financial results, containing condensed summarized statements of financial position and results of operations.

SIGNATURES

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

	Heritage Commerce Corp (Registrant)
May 10, 2004 Date	/s/ William Del Biaggio, Jr. William Del Biaggio, Jr. Interim Chief Executive Officer
May 10, 2004 Date	/s/ Lawrence D. McGovern Lawrence D. McGovern Chief Financial Officer

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Exhibit Index

Exhibit	Description
4.1	Settlement and Standstill Agreement dated May 5, 2004 relating to proxy contest involving James “Jim” D’Amico, Arthur “Art” Carmichael, Jr., William “Boots” Del Biaggio, III, William “Bill” D. Dallas, Tracey Enfantino, Robert W. Peters, Gary L. Thornhill, Ranson W. Webster and Norman “Norm” P. Creighton.
4.2	Company’s press release of May 5, 2004 relating to signing of Settlement and Standstill Agreement dated May 5, 2004 (exhibit 4.1 to this report)
31.1	Certification of Registrant’s Chief Executive Officer Pursuant To Section 302 of the Sarbanes-Oxley Act of 2003
31.2	Certification of Registrant’s Chief Financial Officer Pursuant To Section 302 of the Sarbanes-Oxley Act of 2003
32.1	Certification of Registrant’s Chief Executive Officer Pursuant To 18 U.S.C. Section 1350
32.2	Certification of Registrant’s Chief Financial Officer Pursuant To 18 U.S.C. Section 1350